

**THE STATE OF THE INTERNATIONAL
FINANCIAL SYSTEM, INCLUDING
INTERNATIONAL REGULATORY ISSUES
RELEVANT TO THE IMPLEMENTATION
OF THE DODD-FRANK ACT**

HEARING
BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED ELEVENTH CONGRESS
SECOND SESSION

—————
SEPTEMBER 22, 2010
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Printed for the use of the Committee on Financial Services

Serial No. 111-155



U.S. GOVERNMENT PRINTING OFFICE

62-680 PDF

WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
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**THE STATE OF THE INTERNATIONAL
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Wednesday, September 22, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Watt, Moore of Kansas, Miller of North Carolina, Green, Cleaver, Foster, Adler; Bachus, Castle, Royce, Biggert, Hensarling, Garrett, Neugebauer, Campbell, Posey, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will convene. I, again, explain, not apologize, it wasn't my decision—we had scheduled this hearing, and the Minority had pointed out that we have a statutory requirement to have it and we have not lived up to that, and I appreciate their making it clear and they were correct.

The hearing had been scheduled on the assumption that we would have been voting last night and that a full complement of members would be here. So just as I acknowledged to the head of the FHA this morning, our witness, the Secretary of the Treasury, is testifying to fewer members than is the norm.

I say that as an explanation, not an apology, first of all, and we apologize for it because we haven't done it.

Secondly, I have yet to meet the Administration witness who minded that people weren't here. We are more often asked to apologize for the people who are here. So we can still proceed and that will mean we won't have to be held—I will say to the members we don't—it may not seem like a lot to others, people will understand this, we can sort of shoot for 6½ minutes, maybe 7 minutes. We don't have to hold strictly to 5 minutes, which can be a constraint.

Now, let me begin my opening statement. I welcome Secretary Geithner. I think he comes to us in general with a very successful record. We had a situation in which the economy when he and the Administration took office was in terrible shape, a very deep recession. We have begun the process of emerging, more slowly than anyone would like for a variety of reasons, and we will be debating those reasons, but it is clear that in every economic area, we have been making some progress.

We are here particularly today to talk about the international area. This committee has jurisdiction over that, in a number of ways, including what is often overlooked, our jurisdiction over American relations with the international financial institutions. I am going to begin with that.

We had a crisis earlier this year. We didn't have one. Europe had a crisis. In fact, if you look at the trajectory of economic recovery, the first slowdown in the pace of recovery is coincident with, and I think caused by, the problems in Europe. We know how interconnected the world is, and it was the Greek debt crisis that really caused the first glitch, and we have not fully recovered from that.

Europe was threatened with a significant set of problems. What happened was there was a European coordinated response, in which we participated and in which we can take a little bit of pride because I think much of what was done to respond to the Greek debt crisis and its implications built on what we did beginning in 2008 and 2009, the joint effort of the Bush Administration and this Congress and carried out by the Obama Administration. People have gotten angrier and there has been more bitterness, but the events from September 2008 to early 2009 were one of the most important bipartisan efforts in American history: Republican and Democratic leaderships in both Houses, and first the Bush Administration and then the Obama Administration collaborating on a set of policies that were: (A) unpopular; and (B) successful.

In fact, much of what was done in Europe built on that and I know there were criticisms of the role of the International Monetary Fund. I think events have now shown that our ability to work with the International Monetary Fund cost us not a single penny of our tax dollars and was, in fact, helpful in containing what could have been a serious problem, although it was serious enough to have been, I think, one of the things that has slowed down the growth.

The second issue is coordination. I have been pleased to read articles in the Financial Times and the New York Times saying that, yes, Basel is a good thing, but it deals with only the banking industry in the technical sense and there is the whole non-bank financial industry where the problems were.

And recently in both Ford Norsen's comment in the New York Times and Patrick Jensen's in the Financial Times, they said the only country that has stepped up to deal in a serious way with the non-bank issues is the United States with our financial reform bill. But we also know that having simply us do it doesn't work.

As I said before, Lenin did manage to cook up a justification called socialism in one country to explain why Marxist predictions that the whole world would fall to him didn't come up. That didn't work very well, socialism in one country, but regulation in one country would work even less well because we have a total fungibility of activity and money. And so what is very important is for us to work together.

I am very proud that we worked very closely with the Europeans, the Australians, the Japanese, the English, who are somewhat separate from the Europeans here, the Canadians, and I think we made very real progress in pulling things together.

We have also been willing to assert our role to defend Americans' economic interests. We have an ongoing situation where we intervened with the European Parliament and the European Union where they were talking about rules that would have discriminated against American hedge funds, and we have had some progress there.

What we will expect the Secretary to do is talk to about our progress there, and I do want to reiterate the importance to us of a provision that was fully supported by the Administration. In the bill that was signed into law in July, there is a mandate to the Federal Reserve and the Treasury to take defensive action against any nation anywhere that lets its financial system be used and its legal system be used as a way to bypass our regulations. We are very serious about that.

Fortunately, or unfortunately, we have experience in that because we have under Stuart Levy, who was a holdover from the previous Administration to this one, good experience in the Administration and the sanctions regime and how you deal with rogue nations. And the experience we have had in being tough there we expect to be applied to any nation that holds itself out as the haven.

The gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, thank you for holding this hearing.

America is the largest economy in the world, and it is actually larger than our three next competitors, and we got there through choice, competition, and freedom, not by a government running everything. And when you go to other countries, you come back to the United States and you know that America ultimately will be okay. We will have a sound economy. We may have challenges, but we will confront them and we will beat them.

A famous investor once said, "I can make money no matter what the rules are, I just need to know the rules." In the wake of this recession, which was brought on by Wall Street excesses and government incompetency, the American people have not asked for a bailout or special favors or for more government programs, and they certainly have not been clamoring for higher taxes. They have asked for two things: for the government to stop making things worse; and for some semblance of economic certainty. They need to know what the rules are. Instead, what we have been given is a bloated bureaucracy, more government control, and still more uncertainty.

In response to the greatest financial crisis this country has witnessed since the Great Depression, many of my colleagues on the other side of the aisle have decided that the answer was not to identify the causes and fix them or to identify where government and the regulators failed. No, they decided that the solution was to draft 2,300 pages of legislation directing the same regulatory agencies that missed the crisis to come up with literally hundreds of new Federal regulations on top of those already in existence and empower a new generation of bureaucrats to exercise command and control over the economy for years to come. In fact, I talked to bankers back in Alabama, and they say, "If the regulators would get out of my bank I could do a better job of stabilizing the mess."

With the recent release of proposed international capital standards by the Basel Committee in Switzerland, yet another element

of uncertainty has been added. We can all agree that banks in the United States and overseas held insufficient capital to withstand the financial panic that struck the global economy in late 2008. Indeed, I pointed out when Secretary Paulson first unveiled the original TARP proposal that the major challenge the banks were facing at the time was a shortage of capital, not a toxic asset problem.

But higher capital standards alone will not provide the stability our financial system requires to support a full economic recovery, and the prosperity our citizens need and demand, and for job creation overreliance on increased capital in Basel, tradeoffs that every member of this committee needs to consider.

Higher capital standards means less credit. Less credit means fewer jobs and less economic growth. We need to make sure the standards we adopt really do make the financial system more resilient without needlessly sacrificing more jobs.

But on to something as important as this, the Administration has failed once again to give the Americans the certainty they need. We don't know how much new capital our banks will need to raise. We don't know how many loans they will call in to meet those standards. We don't know how many businesses and consumers will be denied credit so that the banks can comply with Basel III. And the reason we don't know is that we are still trying to figure out how the Administration is going to implement the new standards and how those new standards will interact with Dodd-Frank. Until those questions are answered, it is impossible to say whether the Basel process will yield a more sustainable global banking system or, instead, serve as yet another obstacle to economic recovery.

Because this is likely to be the last opportunity this committee has to hear from the Secretary, I hope he can provide some certainty for our markets, our businesses, our citizens, and for those citizens who need jobs, and our country desperately needs answers to all those questions.

I thank the Secretary for being here, and I yield back the balance of my time.

The CHAIRMAN. The gentleman from Illinois is recognized for 2 minutes.

Mr. FOSTER. Thank you, Mr. Secretary and Mr. Chairman, for having these hearings.

As the author of two amendments to the House-passed version of the bill that actually survived the Senate negotiations involving both contingent capital and countercyclical capital elements, I was interested to see the third to last paragraph of your written testimony which references the fact they are still in play in the negotiations. I will be asking questions about the details of that state of play and the envelope of the negotiations because I think they are fundamental to making the system more stable and shock resistant, and I look forward to your testimony.

I yield back.

The CHAIRMAN. The gentleman from Texas is recognized for 1½ minutes.

Mr. NEUGEBAUER. I appreciate Chairman Frank for calling this hearing with Secretary Geithner.

The authority to set capital standards is the strongest tool financial regulators have, but it is essential that the regulators reach the right balance, and they haven't always done this in the past. Even without the new regulatory requirements, the marketplace has already pushed banks to increase their capital. Although these standards are complex, our committee has a responsibility to understand the position taken by the United States regulators and the impact this agreement would have on the U.S. financial system and competitiveness.

The new international capital standards can have just as much impact on our financial system as our regulatory bill that we just passed recently.

I would like for Secretary Geithner to provide us with assurances that we are using good data and analysis to set these standards. It is unclear to me whether anyone really ran the numbers on what these standards would be before we agreed upon it. I am also interested to know how the United States plans to implement the agreement if it becomes final, and while there are dates set out in the agreement, the timing of when the U.S. regulators choose to issue regulations determines when these rules actually become in effect.

And so with that, I yield back the balance of my time.

The CHAIRMAN. The gentleman from California, Mr. Royce, is now recognized for ½ minutes.

Mr. ROYCE. Thank you, Mr. Chairman. I think all of us have to remember that overleveraging throughout the financial sector, certainly leading up to the crisis, is what brought a lot of the conundrum to us. We had investment banks leveraged at 30:1. We had Fannie Mae and Freddie Mac over 100:1. So over the long run, we need to ensure financial institutions are sufficiently prepared for a downturn.

But as the head of the Dallas Fed told us, requiring additional capital against risk sounds like a good idea but is incredibly difficult to implement. And since 1864, regulators have been struggling to stay ahead of the game when it comes to capital regulation. One of the problems we have here is that Europe is going to drag their feet. We are going to go forward, and that puts some of our firms at a competitive disadvantage.

In my opinion, the most troubling aspect of Basel III is its reliance on the old model of risk weighting assets because it assumes that the securities which have been risky in the past are the same that will be risky in the future. And under this regime, banks will need to hold more common equity than ever against their risk weighted assets, which in turn incents these institutions to find low risk weight assets with some return since these assets can be leveraged much more highly.

So, Mr. Geithner, you can correct me if I am wrong later, but this is going to lead to double A rated sovereigns are going to carry a risk weight of zero if I read this right under this proposal. So looking at the CDS spreads on Italy, on Ireland, they are far from risk free, and with this in mind, Mr. Geithner, I hope you can shed some light on exactly what will make Basel III different from Basel II and every other attempt at regulating capital, especially with the Europeans already telling us they are going to drag their feet on this. I don't think history is on our side.

I yield back, Mr. Chairman.

The CHAIRMAN. I made a miscalculation. We now have 2 minutes left on that side. I am just going to take one more minute, we have more time here, and I didn't have others who wanted to speak.

I just want to talk about an institutional problem that has occurred to me that we are all going to have to focus on. The European Community is still in the process of a constitutional evolution. The roles are not as clear. The role of the European Parliament has been increasing. It was initially fairly weak vis-a-vis the Commission. What we have encountered a couple of times now, particularly in the hedge fund, is I think a lack of clarity in Europe, in the community, between the role of the European Commission, the executive part, and the Parliament. And for example, with regard to hedge funds, I believe it was the case that it was the Parliament that was being more restrictive. I am merely following up on what the gentleman from California said. One of the things we are going to have to give some attention to is that.

Now, we have begun meetings. We have met several times with the European Parliament's committee of jurisdiction. They have their own problems obviously with many different nations, but that is one of the issues that we are going to have to look at because as we get to coordination—and it is not surprising, we are elected officials. We understand that. The kind of nationalism and resistance to international cooperation is greater in the Parliament than it is in the executive.

And I just note that as we go forward, no matter who is doing what, that is one of the things we are going to have to be working with our European friends to address.

Now the gentleman from Texas, I believe, has 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

I am certainly glad that the Secretary is here to address Basel III, and I want to take advantage of an infrequent occasion to agree with the Secretary, having read a portion of his testimony, that indeed the liquidity and capital standards were a major contributor to the economic crisis that we had, and clearly, internationally, capital standards were not applied consistently, which in some respects begs the question, why did we pass legislation, the Dodd-Frank bill, that goes so far beyond capital liquidity standards, getting into bailout mechanisms, product banning authorities, price controls, and the list goes on.

Nonetheless, as important as Basel III is, we know that it doesn't take effect until 2013. The American people are more concerned with where are the jobs today, why does unemployment continue to hover around 10 percent for almost every month that the Obama Administration has been in existence? The American people are asking after two consecutive trillion dollar plus deficits, when will the madness end, when will this President and this Congress take their foot off the spending accelerator and put it on the brake as they drive down the road to national bankruptcy?

Fundamentally, this economy is not suffering from a lack of capital. It is suffering from a lack of confidence. Between the health care bill, the tax increases, the financial regulation, the cap-and-trade and mind-boggling debt, job creators are mired in uncertainty and feel nothing but hostility from this President and this Con-

gress, and I hope in the question-and-answer portion that the Secretary will have an opportunity to address these topics.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. Mr. Secretary, you are now recognized.

**STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER,
SECRETARY, U.S. DEPARTMENT OF THE TREASURY**

Secretary GEITHNER. Thank you, Chairman Frank, Ranking Member Baucus, and members of the committee. I am going to confine my opening remarks to what I regard as the most important elements of international financial reform.

You gave us a very strong hand in the Wall Street Reform Act, in the Dodd-Frank bill, and we are trying to use that hand to play a leadership role internationally in trying to make sure we put in place global standards that help protect American interests. And last week, the Federal Reserve, the Office of the Comptroller of the Currency, and the FDIC reached agreement with their major foreign counterparts to substantially increase the levels of capital that major banks will be required to hold. By forcing these institutions to hold more capital, we will significantly reduce the risk of future financial crises and reduce the damage caused by future financial failures.

Failures in our system of capital requirements were a major contributor to the crisis. Where we had capital requirements, they were too low and they were not supplemented with complementary liquidity requirements. Furthermore, there were no meaningful capital requirements in place for the shadow banking system of investment banks, AIG, and a diverse mix of large non-bank banks and finance companies.

Finally, capital standards were not applied consistently around the world. Banks in many parts of the world were allowed to run with low levels of capital relative to the risks they took on.

I want to highlight what I regard as the most important elements of these new global standards. First, the amount of capital that banks will be required to hold relative to risk will, as I said, increase very substantially. Under this new agreement, major banks will be subject to two tiers of requirements. All firms will need to hold a substantial minimum level of capital, and in addition, they will be required to hold an additional buffer of capital above the minimum. And these two separate requirements have been set to ensure that the major banks hold enough capital, that they will be able to withstand losses similar to what they faced in the depths of this recession and still have the ability to operate without turning to the government for extraordinary help.

Second, banks will be required to hold more capital against the more risky assets, against more risky products and more risky activities, including derivatives that caused a substantial role in the crisis. These assets and exposures are held predominantly by the very largest firms, meaning that this aspect of the new reforms will fall most heavily on the large banks and have only a very modest impact on small banks.

Third, the Basel agreements will improve the quality of capital that banks hold. The new requirements are set in terms of high

quality common equity, tightly defined to mean capital that will truly be able to absorb losses when firms get into trouble.

Taken together, these new agreements will impose a very substantial increase in capital requirements on the major banks that operate around the world. The changes in the ratios themselves represent a more than threefold increase.

But in addition to this—this is important—the new, more restricted definitions of capital and the more stringent assessment of capital against risk will raise the capital requirements even further, and again, these additional effects will fall most heavily on the largest, most interconnected, most systemic institutions in our markets.

Now, in addition to these new capital requirements, the Basel Committee has agreed to impose new global standards for liquidity management. These new liquidity standards are designed to ensure firms can withstand a severe shock to liquidity without facing a deepening crisis.

And finally, the agreement offers the promise of a more level global playing field with less risk to us, less risk than we faced before this crisis, that other countries will be able to allow their banks to operate with lower standards than those that will apply to the major U.S. banks. These are very tough standards, and they will require banks to run with less leverage, with more capital and more stable funding than was true before the crisis. But if we were to apply these standards too quickly, we could hurt economic growth and recovery. And to limit that risk, that possible risk, the agreement gives banks a substantial transition period to meet the new standards.

Now, it is important to note that because we moved so quickly with the bank stress tests in early 2009 to force our banks to raise more common equity, the U.S. financial system is in a very strong position internationally to meet these new global rules. For the most part, our major banks should be able to meet these new requirements through future earnings over time, which will also help protect the economic recovery now under way.

This is a major milestone in the process of global financial reform, but we still have some more work to do. The liquidity requirements will need more work before they are fully implemented.

And I want to emphasize that it is very important to us that these new standards are implemented by national authorities around the world in a way that generates a level playing field. It is not enough just to have a clear measurable minimum floor on required capital. There needs to be tight, consistently enforced limits on the ability of banks and national supervisors to apply these standards in a more permissive way for their institutions.

These new standards have to be implemented at the national level. The agreement that was just reached and the Basel III proposals must be fully implemented through national regulations by the end of 2012. The United States is committed to meeting those deadlines.

I want to emphasize, Mr. Chairman and Ranking Member Baucus, that we will continue to work closely with this committee as we implement the financial reform bill and as we work together to

strengthen global financial standards so that we have a level playing field.

But I want to conclude my remarks by just noting for the record that we are about to close another chapter in the work of this committee to end this financial crisis. This morning, Assistant Secretary of the Treasury Herb Allison announced he was stepping down as the head of the Office of Financial Stability. He and his team, working with Lee Sachs, who was then counsel to the Secretary of the Treasury, were the architects of what is increasingly regarded by outside experts as one of the most successful emergency programs in financial history.

And I want to mark that event in the upcoming formal end of TARP authority by praising the political courage of President Bush and Secretary Paulson and those in Congress, Republicans and Democrats, who voted at that grave moment of financial peril to give the government of the United States the authority to solve this financial crisis.

If you are a conservative Republican, you can celebrate the fact that we solved the most dangerous part of this financial crisis largely with private capital, not public capital, and you can welcome the fact that we have reduced those investments in the American financial system to a tiny fraction of those I inherited, and every day we are working to extract the government from those remaining investments.

If you are a fiscal conservative, you can celebrate the fact that CBO now estimates that losses on the TARP investments will be in the range of \$66 billion, less than 10 percent of the \$700 billion in authority provided by the Congress.

If you are a liberal or a progressive, you can welcome the fact that after a lost decade for the middle class and a crisis which left millions of Americans out of work and living below the poverty line, we did not have to spend hundreds of billions of dollars of scarce taxpayer resources on banks, which gives us more room to protect investments in our critical priorities of the country.

If you care about manufacturing, you can celebrate the fact that the American automobile industry is stronger and leaner today than it was before the crisis, and that businesses across the country find it easier now to raise capital to access credit than they did before the crisis and in the peak of the crisis when we took office.

And of course, all Americans should be relieved that their savings today are safer and more valuable than they were in the fall of 2008 and that we were careful custodians of their scarce resources.

Now, I know a lot of people who voted for TARP decided later that they had to distance themselves from that vote by disparaging the programs, but I think they should be proud of the votes they cast. They were on the right side of history.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Geithner can be found on page 50 of the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary, and I will probably see the Republican leader, Mr. Boehner, later today and I will pass along to him your thanks. He was of course one of the staunch sup-

porters of the TARP. I don't know if I will run into Senator McConnell, but I will be glad to do the same with him.

I was just reading Secretary Paulson's book and noted his quote of the comment from Mr. Boehner, "We would be crazy not to rescue AIG." So I appreciate that.

I want to talk about one piece of this, and that is the automobile piece. There is a lot of discussion today in this country about our need to protect and, in fact, expand the amount of manufacturing we have. There is a repudiation of the notion that we can exist as a successful economic nation, offering a full range of opportunities to all of our citizens at various levels of skill and education, if we don't have a significant manufacturing component. So manufacturing support gets a lot of rhetorical service.

It seems to me that the single most successful effort of public policy to advance manufacturing and to make sure it stays here doesn't get that respect, and that was the decision initiated by President Bush, because again, I think you are correct about the bipartisanship, and then carried out further by this Administration with the authority a bipartisan Congress had given, to intervene on behalf of both General Motors and Chrysler.

And we ought to be clear that while Ford was not itself the beneficiary directly of those funds, Ford strongly supported the funds being made available to General Motors and Chrysler from the standpoint of keeping manufacturing in America because Ford feels that if General Motors and Chrysler went bankrupt and were to substantially diminish their activity and perhaps Chrysler disappeared, one result would be that the amount of manufacturing that went on for the auto industry, the supply chain in the United States would have been damaged, and Ford would have been at a severe disadvantage in trying to keep its manufacturing going.

So I would ask you to reflect not just on the financial aspect, because I gather with General Motors when you are talking about them beginning to repay or they have already begun to repay some, what would the effect have been on this very important sector of American manufacturing, automobiles and the supply chain for automobiles, if the Bush Administration had not initiated and your Administration had not followed up on an intervention in the automobile industry.

Secretary GEITHNER. I think you are absolutely right, Mr. Chairman. The effects would have been devastating. You would have seen thousands and thousands of jobs lost, hundreds and hundreds of small suppliers affected by the collapse, and it would have dramatically amplified the damage caused by this recession.

And if you care about our capacity to make things in America again and to make sure that we are strengthening our ability to make things in this country again, you have to look at that intervention, that strategy, again initiated by President Bush, and view it as an incredible success.

I don't want you to understate, though, the importance of the financial changes because the great strength of the American economy over the decades was the fact that our financial system was the best in the world at providing capital to people with an idea that could build a growing business. We lost our way along the way and created a system that had too much risk and that was a dev-

astating mistake, but we are substantially along the way to restoring that fundamental strength of the American system.

The CHAIRMAN. Let me build on that because one of the arguments against the intervention is from people who say, look, the intervention might in and of itself be a good thing but it becomes addictive and that there is no such thing as an intervention and then a withdrawal, that what you then have is what should be the private sector becoming dependent.

My view is that what we had with both the financial system and with the automobile manufacturers, certainly with GM, was a specific intervention, but the intervention worked in that the entities are now doing well on their own, and we are in the process of withdrawing that. So the argument that once you intervene you own this and you can't get back to the private thing has been repudiated by the experience. Would you comment?

Secretary GEITHNER. I agree, and no one should ever have to be in a position to take these steps, but in that case, because they were forced to go through a deeply wrenching restructuring process, they are emerging sooner, more profitable than anybody expected, and they can stand now on their own, and that is also now true for the American financial system as a whole.

So it is not just that the system is stronger today than it was before the crisis, certainly when we came in office, but that we have let the weakest parts of the system go away and those that survived were able to meet a market test, being able to raise private capital on the strength of their franchise, their basic solvency.

So I think we have been very careful to design these programs in a way that makes it very likely people would look at the prospect of government intervention in the future as being an easy, attractive option for them; it was devastating for the firms involved but our system, our country is stronger for it.

The CHAIRMAN. The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman.

One thing I might say about the making money, House Republicans, particularly this committee, Republicans on our committee stood strong against the original proposal to the toxic assets, which proved to be a real boondoggle, and it was not done, and we actually insisted on dividends and warrants, and that is the part of the program that has made money.

Secretary GEITHNER. I compliment you on that, by the way. You said at that beginning, and you are absolutely right, that at that time—and this was the principal cause of the crisis and the most damaging part of the dynamic was a perception that U.S. firms did not have enough capital.

Mr. BACHUS. That is right.

Secretary Geithner. But if you look at the program, where the returns to the taxpayers have been the highest is because those capital investments have earned a very substantial positive return, more than \$20 billion in positive returns to the American taxpayer. It was the most effective use of taxpayers' money that you could conceive of doing to help resolve a crisis like this.

Mr. BACHUS. And actually, Chairman Frank stood with the House Republicans, who actually on the first meeting proposed those dividends, proposed capital injections.

We did oppose AIG. In fact, when Secretary Paulson—and I corrected him when he put in his book that he informed all of us. He failed to call me and inform me of the AIG intervention, and when I called him, he acknowledged that fact.

The CHAIRMAN. If the gentleman, because there was a lot of camaraderie there and we should be clear, the AIG intervention was unilateral by the Federal Reserve, and at the time didn't need any congressional approval. Subsequently both sides, though we had some differences in the financial reform bill, in both versions of it, we repealed the provision, section 13(3), by which the Federal Reserve did that.

Mr. BACHUS. I am just saying that Congress has gotten some credit for some of the programs which lost money when actually—the programs that made money, we insisted on that protection for the taxpayers, and I am proud of Roy Blunt and I am proud of the subcommittee ranking members on this side and Jack Reed on the Senate side and Chairman Frank and others who supported that.

Secretary GEITHNER. Mr. Bachus, could I just reinforce one point you are making? I am very confident when we look at this crisis, that if you look at the full complement of what the FDIC did, they will have been even to making money. The Federal Reserve programs, in totality, all of them, looked at together, will also offer a substantial return to the American taxpayer.

Mr. BACHUS. And let me say this, I am not debating that, but a lot of the actions that were taken, Congress did not approve or participate in. They were unilateral and made by the Federal Reserve.

Let me just ask you one question. The President recently appointed Elizabeth Warren to head up really I think the most powerful agency that has been formed by the government in the last 30 years, which I think is a credit—and also has the power to allocate credit and to set fees. Many of us oppose giving them that *carte blanche* effect. Now, he has gone around Senate confirmation, despite the fact that Article II, Section 2, says “advise and consent of the Senate,” and he did that on Constitutional Day, which was sort of an “in your face.” My first question is, is he going to go to the Senate or is he going to just avoid that?

Second, because he appointed her as a Presidential appointee on the White House, he could claim executive privilege in her testifying before us. Is he going to assert executive privilege?

And third, the bill is written to where actually this agency has a right, the Federal Reserve, to pay as much as \$680 million to fund that agency. Is Congress going to have any control over that, which I think the Constitution also provides that we at least control the spending?

The CHAIRMAN. If the gentleman would yield, and I will give him extra time, before you answer, Mr. Secretary, I want to join in one part of that. I was supportive of that process, but I would be very unhappy if there was any obstacle to Ms. Warren testifying before the Congress, and I hope we will get an affirmation that will in no way be an obstacle to her testifying.

Mr. BACHUS. Thank you. Mr. Chairman.

Secretary GEITHNER. Congressman, let me start with the following.

There is no risk that this agency—although it is true it has been given substantial authority—has the authority to allocate credit and set the price of credit across the American financial system, and I would not be part of it, would not support it if it did; that is not in the law.

What this bill does do, though, is take a bunch of authorities that were spread across multiple Federal agencies and put them in one place so there is one place with a dedicated mission to provide Americans better protection for their financial security; that is, it was a necessary, just act.

The President is going to nominate a person for the Senate to confirm to lead this agency over time. What he has asked Elizabeth Warren to do, with my full support, is ask her to come play an advisory role to us as we help stand up this agency and figure out how to make the best use possible of that basic law. And I want to say that we are absolutely committed to making sure we do this in a way that strikes a careful balance.

I will give you an example. The first thing we have done was yesterday, we convened a group of experts around the country to talk about how to make mortgage disclosure more simple, more accessible. Why is that important? Disclosure is one of the most powerful tools we have for making sure people can make sensible financial decisions, can shop for the best possible deal, can protect themselves from being taken advantage of.

Mr. BACHUS. Mr. Secretary, we all support the Treasury. Let me just ask this: Can you guarantee us that she will not exercise any rulemaking authority until Senate confirmation?

Secretary GEITHNER. She can't—I didn't speak to the question about—I just said that the President will nominate a director for confirmation by the Senate.

Mr. BACHUS. And do you know when that will happen?

Secretary GEITHNER. On the specific question of testimony, I am a little reluctant to say this, I want to make sure I get it right. It is my expectation, of course, that she would be obviously happy to testify with respect to her duties at the Treasury in this role as adviser to me and the President on the initial design of this agency.

Now, on the question of rule-writing authority, the statute makes it absolutely clear what authority the agency has before there is a confirmed director and before the date of transfer, I think. And it is fair to say that until that authority is transferred, which will not happen before July of 2011, and before there is a confirmed director in place, this agency, by statute, has very limited authority to actually write new rules. But we are going to try to use that interim period to try to build a stronger consensus among the major players on how to improve disclosure and things like that.

Mr. BACHUS. Of course, if she picks the rulemakers, that is kind of a stacked deck, too.

Secretary GEITHNER. No, but again, that authority is with the President and me, and it is not something that falls anywhere else, and of course none of can have any powers that the statute didn't give us.

Mr. BACHUS. We disagree with a lot of that statute.

Thank you.

The CHAIRMAN. I would notice, disagreement with the statute that has been signed into law doesn't have a lot of legal force.

Mr. BACHUS. I believe in the rule of law.

The CHAIRMAN. That is the statute that you disagree with.

Mr. BACHUS. No, I am not advocating disregard for the law.

The CHAIRMAN. If the gentleman would yield, when we wrote that law, it did occur to us that Senate confirmation might be problematic. So it is not accidental that there were abilities to function until the Senate confirmed someone.

Mr. BACHUS. But we also wrote in that law that he or she would be appointed by the Senate.

The CHAIRMAN. Not appointment by the Senate.

Mr. BACHUS. Advise and consent of the Senate.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

Mr. Secretary, we have all focused on what went wrong in the financial crisis, and appropriately so, but I think it is equally important learn to from the responsible actors and build on their successes. So, last month, the Oversight Subcommittee I chair held a field hearing in Kansas to listen to, and learn from, responsible Midwest banks and credit unions who were not the cause of the financial crisis. While these smaller firms were clearly not "too-big-to-fail," many raised the question to what extent the Dodd-Frank Act and the Basel III agreements finally end "too-big-to-fail." I believe they will over a short period of time, but I would like to hear from you, how will Basel III specifically help end "too-big-to-fail?"

Secretary GEITHNER. Excellent question, and to answer, you have to look both at the capital requirements and their effect and what the Dodd-Frank Act did to our ability to dismember a major institution without causing huge damage to the American economy.

Capital is important because it reduces the risk that any individual firm will fail, but it has a more powerful separate effect, which is that it raises capital requirements for everybody else, too. They are much more likely to be able to absorb the trauma, the loss, the shock that could happen when a major firm collapses. So it has that huge effect of reducing the risk of failure, reducing the probability of a major crisis and the losses associated with the crisis.

But what the bill does is essential, which is it also says if in the future, a major firm manages itself to the point where it can't survive without exceptional assistance, we have no option but to put them through an orderly dismemberment that allows us to reduce any risk to the taxpayer and protect the innocent from the collateral damage that we saw that was so traumatic in this crisis.

So the combination of the bill, that framework, the authority for capital and to dismember are the most effective ways we know for ending the problems associated with "too-big-to-fail," and very important is this bill and these capital standards put much tougher restraints on the big institutions than they do on the small, because we want to preserve a financial system that allows for the great diversity of strength we get from having a system of 9,000 banks, community banks, small banks, credit unions across the country that provide critical financial services to Main Street America.

Mr. MOORE OF KANSAS. Thank you, Mr. Secretary.

The recent Basel agreement with respect to capital standards appears to be very good. I am a little concerned that the implementation period is too long or may be too long, but tripling the capital ratios appears to be a very good step in strengthening financial stability.

I am also pleased the new agreement is countercyclical, building on key provisions that the New Democratic Coalition, led by Representatives Bean and Foster, pushed to have included in the Dodd-Frank Wall Street Reform Act.

Mr. Secretary, will you please profess how the countercyclical nature of these new Basel capital standards will strengthen financial stability? For example, if these rules had been in place 10 years ago, would they have helped mitigate the recent financial crisis?

Secretary GEITHNER. Just to start where you ended, absolutely. Our system would have been much more stable, much more resilient, much better positioned to handle a recession like this if we had tough requirements in place.

And just to echo something the chairman said at the beginning, one of the most important things the Dodd-Frank bill does is make sure we can apply capital requirements to those who are in the business of taking risk in lending. In the previous system, we could only apply them to banks. They didn't exist for a whole range of institutions that competed with banks and were allowed to take on much more leverage and risk, and that was very catastrophic for the system. So Dodd-Frank allows us to apply them evenly across institutions that are in the business of banking, regardless of what they call themselves.

Now what this agreement does is—I will give you two examples of how it makes the system more resilient, less procyclical, more stabilizing in boom. What you want to do of course is reduce the tendency to euphoria in a boom and to panic in a crisis, and the best way to do that is to make sure that people operate in a boom with higher requirements so that they can dip into those as they face the losses that happen in downturns.

And what this agreement does is allow you to—you have to run with 7 percent against risk, which is more than triple the previous standard, but as you face losses in a recession, you can dip into that cushion of capital. Now, if you go past a certain point, you have to start to conserve capital, stop dividend payments, stop share buybacks or raise capital, reduce compensation, and that feature should make the system less procyclical than it was in the past.

But as I will say in response to Congressman Foster's questions later, we are still examining whether we can complement this framework with other forms of contingent capital, countercyclical capital so that again we make the overall system less vulnerable to booms and less vulnerable to panics in the future. I don't think we have found the adequate answer to that question, but this puts us in a much better position than we were before the crisis.

Mr. MOORE OF KANSAS. Thank you, Mr. Secretary.

The CHAIRMAN. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Secretary. I appreciate you being here.

One of the things I am a strong proponent of is making sure that these entities are adequately capitalized, and I believe that part of the problems that we faced where we did have some entities that didn't have the capital to sufficiently cover the risk that they were taking. And as I read about the agreement that was reached, I see a couple of things there. One is that we are going to increase the capital requirements across-the-board and then we are going to increase also or more clearly define what capital counts towards meeting those goals.

But there is a point out there with capital, and what you are going to do with those entities is going to raise the cost of capital for them in many ways. So, across-the-board, you are going to have all these entities out looking for additional capital. It is going to raise the cost of capital.

And so in order to be able to continue to generate the returns to the investors in these entities, obviously there is going to be huge pressure on them to increase their income or their revenue streams. And so one of the questions that kind of pops into my mind is, is there a point there where we put so much restraint and capital requirements there that we actually encourage riskier behavior in order to meet the returns and to pay for this capital, and so how do you balance that?

Secretary GEITHNER. Excellent question. It is a thing worth worrying about. I think the architects of this were very careful to take that into consideration.

Maybe this is one way to explain how it does that, which is to say if you take more risk, you have to hold more capital against that risk. Now, if you again look at the mistakes made prior to this crisis, you could say that people were able to hold on to all sorts of assets that they thought were risk free that actually had a lot of risk in it, and that was a costly failure. So by raising the risk you have to hold against the complex, inherently much more risky activities, you reduce exactly the incentive problem that you described.

Now, capital doesn't solve all problems. You have to make sure that you have a risk management system, you have a set of internal controls, you have tough supervisors looking over the stuff to make sure that people can't get around these constraints and evade them, and you have to be careful about going too far because if you get these capital requirements too high, then you will raise the cost of credit unnecessarily, and you will encourage people to move their risk outside of the banking system again, and that would not create a more stable system. So you have to get a balance right, and I think this is a very strong agreement and has a much better balance than we had before the crisis.

Mr. NEUGEBAUER. One of the questions, though, and you make a point, is that one of the key parts of that then is the regulatory structure, making sure that the risks are being identified and recognized, but the question I have is, let's take bank A in the United States and they have a 7 percent capital requirement that they are meeting and we have a bank in another country that says we are meeting the 7 percent but their regulatory structure may not be as rigorous as the U.S. regulatory structure. So, in fact, that bank is

able to engage and leverage their risk in a different way than the U.S. bank is. How do we protect the markets in that way?

Secretary GEITHNER. We are very worried about that for the obvious reasons you are, and again, if you look at what the system was like before the crisis, there was very, very substantial scope for countries to let their banks run with much lower capital than our banks were forced to run with. The required minimums were lower. They could count all other sorts of stuff as capital that we didn't allow people to count, and in addition, we don't think they were as tough on how they accounted for risk as our supervisors are. And I know that if you look at the mistakes we made in the United States, it is hard to understand this, but in fact the requirements we had in place for our banks were substantially tougher than was true for banks in many of the major economies around the world.

So what this agreement does is substantially narrow the capacity for countries to have their system run with lower standards, because it is much tighter definitions of what counts as capital, much tougher risk weights on risky assets, and a higher overall minimum standard. And I think the combination of things give us much more confidence that it will be applied evenly. It is not enough, though. We have a lot of work to do to, as I said in my remarks, to make sure that as the regime is operating we don't let too much discretion seep back into the system that would put us at a competitive disadvantage.

The provisions in the bill give us a strong hand and we are going to make the whole system much more transparent, so there will be a good market test all the time about how much capital these guys are actually allowed to run with. And we are going to be and have to be very careful, monitor very carefully and pursue much more aggressively any signs of differential standards.

Mr. NEUGEBAUER. So will it be specific risk premiums, a prescriptive way on certain types of assets that everybody across the spectrum will be required to use in analyzing the amount of capital and the risk in that portfolio of assets?

Secretary GEITHNER. It is not quite that, and there is risk in that approach, too, because then if you do that, if you have the government just sit there and prescribe the risk weight, then there is a real risk people can just get around that, arbitrage around that, and leave the system more risky.

What it does is make sure that there is a common framework you have to use for how you measure risk, and that basic framework has to be common across countries. It is not perfect. There is still a lot of risk. People will operate it with different degrees of rigor, which is why we are going to have to be on this for a sustained period of time.

But we have a much better chance now that we will be able to watch this stuff on a quarterly basis and see where firms who compete against each other are operating with different actual standards of leverage.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Mr. Secretary, I am committed to try to get as much of our money back, taxpayer money back as possible that has been expended or loaned as a part of all of this, TARP, as well as the con-

servatorship of Fannie and Freddie. A couple of months ago, in July, FHFA, the Fair Housing Finance Agency, sent 64 subpoenas to try to determine if there were legal claims arising from their private label mortgage-backed securities. In the Bush Administration, they were pushed to take on the highest—fill the housing goals that they have ever had, and they were allowed to meet those goals by buying the mortgage-backed securities, frequently subprime, generally subprime mortgage-backed securities issued by their bitter rivals, their heavy competitors. And those mortgage-backed securities appear to be one of the many areas of losses. We now have \$145 billion or more into that conservatorship. The subpoenas seem to be aimed at a couple of different claims. One is outright fraud, but another is simple breach of contract, which is a lot easier to prove than fraud, that there were representations, there were warranties about the mortgages that were in the pools that had been purchased from the securitizers, for the most part, the big banks.

And Mr. Kanjorski, Ms. Speier, and I sent a letter to President Obama last month urging that all of those claims be pursued vigorously, any available legal claims that will limit the losses to taxpayers. Mr. Frank since then has supported that position. Do you support pursuing with enthusiasm legal claims that we may have to minimize our losses?

Secretary GEITHNER. Absolutely.

Mr. MILLER OF NORTH CAROLINA. Okay. So you support the subpoena, the request for information?

Secretary GEITHNER. I don't think I can speak with sufficient care or clarity about the precise legal tools we have available to us, but it is very important to us that we are very aggressive in pursuing the taxpayers' interest in limiting the scale of losses that were inherited at the time of conservatorship.

Mr. MILLER OF NORTH CAROLINA. Do you have any or was potential liability on these theories taken into account at all in the stress test? The securitizers who presumably would be the defendants in any litigation are the 19 biggest banks that got the stress test. Was there potential liability taken into account at all in the stress test a year ago?

Secretary GEITHNER. I don't think so. I would have to refer that question to my colleagues in the Fed, but the broad parameters of losses that were estimated in the stress test on mortgage exposures were very, very tough. Very, very tough. In fact, the loss rates that underpinned the stress test assumed losses higher than the U.S. banking faced in the Great Depression.

Mr. MILLER OF NORTH CAROLINA. But of course, those mortgages were off their books at that point.

Secretary GEITHNER. Some were on the books, some were off, but they were very careful to also try to capture the contingent off balance sheet exposure that these firms run with. But I will refer to the Fed your question about precisely whether—

Mr. MILLER OF NORTH CAROLINA. There was also pending litigation that so far has not gotten past certain procedural defenses but may well end up getting past those procedural defenses by the private purchasers of those mortgage-backed securities, for the most part pension funds, insurance companies, some hedge funds, that would have substantially identical claims to the claims that Fannie

and Freddie would have that FHFA would be pursuing in the conservatorship. It seems that if they get past—and the litigation brought by the Massachusetts Attorney General seems to show that almost all of those mortgages failed to meet—the subprime mortgages in the mortgage-backed securities failed to meet representations and warranties. Could you also consider that or let me know if that potential liability was taken into account in the stress test?

Secretary GEITHNER. Again, I will be happy to refer those questions, and of course, we have your letter and we are looking through exactly the issues you raised in your letter and how best to respond to those. But we will be happy to pursue those with you.

Mr. MILLER OF NORTH CAROLINA. Mr. Chairman, my time is close enough to having expired. I yield back.

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Secretary Geithner, you said in response to Ranking Member Baucus that until July, the CFCB, this new agency, will have very limited authority to write new rules and sort of acknowledged that before next July that it will plan to do that.

But I noticed yesterday that you and I guess it is Advisor Warren—is that what she will be called—hosted a closed meeting about mortgage disclosures. And in the Treasury press release you were quoted as saying, “Moving quickly to improve mortgage disclosures is in a series of concrete steps we are taking.” And you continued that, “Whenever possible, we are committed to expediting completion of the law’s requirements ahead of statutory deadlines.”

Changing the mortgage disclosures required under RESPA and TILA to me is costly to small businesses. We have been working on whether the—trying to get the Federal Reserve and HUD to work together on ironing those out, and that seems to be a long process that didn’t really get there, I don’t think. But with this endeavor or any other rule or regulatory change spearheaded by you and Ms. Warren, do you plan to consider the consequences for small businesses and how do you plan to do that?

Secretary GEITHNER. Let me just say that I think it is very hard to look at the existing body of regulations in these areas that were designed to improve disclosure and protect consumers and be proud of what they have achieved, both in terms of the burden that they impose on people providing financial services as well as the benefit they provided to consumers. And I think, my own personal view, is where we have authority, like in this area, to try to combine these forms, bring convergence or put new protections in place, it is an obligation on us to try to make sure we can find ways to streamline the existing body of rules that have outlived their usefulness or did not meet their stated objectives. I think we have a very substantial scope to do that; and I think it is very important to us, to the whole credibility of this effort, to try to demonstrate that we are not just putting new rules on top of old bad ones, that we are cleaning out the underbrush and trying to lighten the burden on people who have to—are in the business of trying to help people borrow responsibly.

Mrs. BIGGERT. If I might, you have, under the law that says that for a covered agency, a description of the steps the agency has

taken to minimize any additional cost of credit for small entities. And this going to be such a problem with what businesses are facing with looking at what is the law right now and how it is going to change. They have spent so much money in trying to work out with the new RESPA and TILA that has been put into place and then to changing this.

And, also, Advisor Warren has criticized the Treasury's data as sparse. And she said that reasonable people may disagree about how to help small businesses gain access to loans, but no one doubts that the solution must begin with a clear understanding of the problem, and yet Treasury has gathered only sparse data on the small business credit crunch.

Do you agree with that or is this something that is going to have to be done?

Secretary GEITHNER. No, I don't agree with that, but I can take this opportunity to say that the Congress is on the verge of passing a set of very powerful, not just tax benefits for small businesses, which we think are very well designed to make a big impact on improving investment in this country more quickly than otherwise would take place, but a very well designed set of programs, credit programs, limited to community banks that will help give them the resources to lend more to growing small businesses.

And my own view, again probably based on our experience with the initial investments we made under the TARP, is that those programs have a—can have a very substantial positive effect on increasing the availability of the credit that small businesses are still living with the scars caused by this crisis. I think that the Senate passed this bill last week, and I am told that the prospects are quite good that it will be the law of the land quickly.

Mrs. BIGGERT. What are Treasury's plans to assess the impact of the new rule or regulation on—

Secretary GEITHNER. I am sorry, Congresswoman. You are right to say that the Dodd-Frank bill does also have a set of requirements that you refer to in making clear that we have to carefully examine the effect on small businesses.

But just to cite the example you said, I find it—I am very confident that improving disclosure and simplifying forms will not just make it easier for consumers to shop for best financial products but do so with a lower burden on the people who provide those financial services. I cannot believe—this is not rocket science—we can do a much better job than we have done to date in reducing the burden on people in part by simplifying these kind of forms in disclosure.

Mrs. BIGGERT. I would hope so, but will there be a comment period, public comment period?

Secretary GEITHNER. Absolutely. Again, one of the great things about the United States is we have a set of important basic disciplines, obligations on transparency requirements for comment and we will meet those obligations.

Mrs. BIGGERT. Thank you.

The CHAIRMAN. The time has expired.

I will just make an announcement, since it came up, that I will be at the Rules Committee at 5:00 today to ask for a rule on that small business lending bill. And it is our intention to ask the

House to accept, after swallowing hard, the Senate version of that bill tomorrow.

The gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

I thank the Secretary for appearing. Good afternoon. Sorry that I arrived a little bit after your testimony. We have quite a busy day on the Hill today, a number of hearings.

Let's talk for just a moment about the alternative. We have a proposal. Can you explain to us what the alternative is? It seems as though there is a notion that there is something much, much better that we could be doing if we would but only do that something that is much, much better. What are the alternatives? If we don't increase capital requirements, what is the alternative?

Secretary GEITHNER. Congressman, I believe there is no credible alternative. You can debate how much is enough, how much is too much, how quickly people should have to build capital to achieve the new minimums. And we can debate and we will continue to work on ways to make this system more resilient, make these shock absorbers work in a way that, as Congressman Foster and others have suggested, that makes the system less procyclical. And we have more work to do on that.

But there is no credible alternative to less leverage, higher capital requirements, more stable funding requirements on institutions. Financial crises all have in common that single basic failure that firms were able to operate with less leverage. That is what makes them vulnerable to panics and runs, and that is what brought our economy to the edge of its knees.

Mr. GREEN. Now, what you are attempting to do and we are attempting to do is make this as global as possible. Would you please address the transparency necessary to implement this in a global market?

Secretary GEITHNER. A clear, measurable, simple standard that countries not just have to commit to abide by but they have to pass national regulations to make those rules apply to their institutions. Disclosure requirements so that the world can look at those institutions every quarter and see whether they are holding enough capital to meet those requirements. A long, ongoing effort to monitor enforcement by supervisors on as consistent a framework as we can. Those are the principal elements of what gives us the hope that we have a much tighter set of constraints and a more level playing field globally.

Mr. GREEN. And, finally, the definition of a bank that will be universal such that we won't have some country that concludes that these institutions, while they look like banks and they lend like banks, they are really not banks.

Secretary GEITHNER. Unfortunately, that was uniquely an American problem. In really almost every other major economy around the world, they had the authority to apply capital requirements to institutions that operated as banks even if they called themselves merchant banks or housing finance companies or banks or investment banks or commercial banks.

Our system was unique in basically saying we had two worlds, a set of banks that had rules and a set of all sorts of other institutions with different types of names that didn't have rules. And that

is why consumer protection was such a failure and that is why this crisis was so much more severe, because people were able to take a huge amount of risk without being subject to those constraints.

So I do not believe that we face material risk, that countries have been scarred by this experience and this crisis—and it was in many ways harder for other countries and even was for us in the United States—will decide they are going to let people evade those basic rules. And if that happened, we would work very hard to convince them that in their own interest, they would want to extend those protections to those nonbank institutions.

Mr. GREEN. I thank you very much, and I look forward to hearing alternatives from those who contend that this doesn't work. And I thank you for the time.

Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

Mr. Secretary, I think it was the day before yesterday that the Nation awoke to the news that, by a narrow definition of economists, the recession ended 15 months ago. Clearly, there had been no celebrations in the street, for obvious reasons.

I really don't have a specific question, but I have a statement and a request. Having spent months now speaking to people not only in my own congressional district, but Fortune 50 CEOs, billionaire investors, and, most importantly to me, small business people in Mineola, Palestine, and Athens, Texas, one word continues to come to the forefront of the discussion: uncertainty. Uncertainty. You have probably seen the NFIB poll of small business confidence had a generational low. Hopefully, you are hearing their voices.

The chief economist, Bill Dunkelberg, for the NFIB talked about how the tax rates, health care, discussion of the deficits "scare us to death."

The Business Roundtable: The voice of big business, government is injecting uncertainty into the marketplace making it harder to reduce capital, create new business.

The U.S. Chamber: It is fundamental uncertainty that is holding business back. Look at the tax costs. Look at the health care bill.

Now, again, I know that the Administration is not going to relitigate and Congress is not going to unpass the health care bill, much less the FinReg bill. But the sheer volume of rulemakings that will take place under this legislation by any historic standard, although perhaps the recession may have ended by some narrow definition, clearly the recovery hasn't started. The recovery will not start until this Administration, working with Congress, fundamentally begins to remove the uncertainty and listens to the voices of job creators. And I do not believe that voice has been heard heretofore.

So that is a combination of a statement and a request. Now, in that vein, I do have a question. You mentioned earlier about this, and I believe you said we have legislation pending for tax incentives for small business. But, unfortunately, you also have proposed legislation that would impose taxes on small business, specifically the Administration's plan to increase marginal rates for the top two brackets. And according to JCT, the Joint Committee on Taxation, that includes 50 percent of all small business income. The Tax Foundation has reported that the top two brackets, that two-

thirds of that revenue produced will come from business income. And so, on top of the uncertainty, now we are adding yet another tax on business in general, small business in specific. Why?

Secretary GEITHNER. Congressman, let me just start with something you said in your opening comments before you asked that basic question. This reform bill will correct mistakes in how we have managed our financial system that caused devastating damage. And as we bring clarity to the rules that will prevail, as my colleague Chairman Bernanke and others did last week on capital, that has been helpful to provide clarity.

If you look at how the markets responded to that, they were, frankly, reassured that the rules struck a good balance between stability and basic growth. And it is very important to us as we move forward to move this bill that we bring that same standard of balance and we are going to do it as quickly as we can.

Now, I talk to businesses across the country all the time as well, and I would say—

Mr. HENSARLING. Unfortunately, my yellow light has already gone off. Could you address the question?

Secretary GEITHNER. Yes, I absolutely want to get to your question.

I talk to businesses across the country as well and I would say that it is unmistakably true that businesses across this country, as are average Americans, are still living with the deep scars caused to their basic confidence caused by the basic crisis. And their principal question, frankly, is how fast is the economy going to grow in the future?

We are having, frankly, a very welcome debate about what is the best mix of policies that is going to encourage investment in the United States and future growth. And let me tell you what separates us now, Congressman, because I think it is important to say this.

Mr. HENSARLING. The seconds are really ticking down, Mr. Secretary. So do you push back on the data? Are you not proposing a tax increase on 50 percent of small businesses?

Secretary GEITHNER. I welcome the question, and I want to explain it to you.

The CHAIRMAN. I would ask unanimous consent that we have 3 additional minutes for the gentleman of Texas. We have a fairly significant debate going on here, and if there is no objection, we will do another 3 minutes.

Secretary GEITHNER. So let's discuss what we agree on and what separates us, okay?

We hope you will join us in passing this set of very powerful tax incentives for small businesses in the small businesses bill. I will give you an example: 100 percent expensing up to a certain limit for small businesses for any capital investment. Zero capital gains on investments in small businesses. These are very well-designed tax incentives that Republicans have supported with fervor in the past.

We have proposed that Congress join the President in proposing, for a temporary period, full expensing for 1 year for capital investments by all businesses in the country, again, to give them the in-

centive to make those investments today to help get Americans back to work.

We have proposed that the government start a multi-year program of improvements in public infrastructure that will help not just put more people back to work but improve future growth rates.

Now, where we—and we have proposed, and I think Congress would support this, to decide soon to extend the middle-class tax cuts that go to not just 97 percent of working Americans but to 97 percent of small businesses across the country.

Now, where we disagree—

Mr. HENSARLING. But it is still 50 percent of the income, Mr. Secretary.

Secretary GEITHNER. Congressman, I am getting to that. That is a deeply misleading, as you know, characterization.

Mr. HENSARLING. No, I don't know, Mr. Secretary, or I wouldn't have cited it in the first place.

Secretary GEITHNER. But I am going to come to it.

Mr. HENSARLING. It is my time, is it not, Mr. Chairman?

I would say, listen, Republicans want to work with you on the immediate expensing, certainly on the capital gains tax relief. I would say, though, that what you give with one hand, this Administration more than takes away with another hand.

Secretary GEITHNER. Not so, Congressman.

Mr. HENSARLING. So, at the end of the day, Mr. Secretary, I don't think this Administration with its proposals is fundamentally addressing the uncertainty that is keeping job growth to almost nil in this economy. Otherwise, again, we wouldn't continue to be mired in almost 10 percent unemployment almost every month of the existence of the Administration. So I suppose we will just have to agree to disagree.

The chairman was generous in giving an additional 3 minutes. In the time I have remaining, I do want to move on to one—

Secretary GEITHNER. Mr. Chairman, can I just respond to that?

The CHAIRMAN. I will ask for an additional minute for a 30-second response from the Secretary, and then it is the gentleman from Texas' time.

Secretary GEITHNER. If you look at the full impact of our suggestions, we extend today the middle-class tax cuts, our proposals for enhanced business expensing for 1 year for all businesses, and our proposal to jump start a multi-year public investment program, the net impact on growth for this country at this time of grave challenge would be much, much more powerful, a substantial multiple, than simply deciding to extend those tax cuts that go to 2 percent of small businesses and 2 percent of the most fortunate Americans in the country.

The CHAIRMAN. I think you got your point across.

The gentleman has the remaining time.

Mr. HENSARLING. Thank you, Mr. Chairman; and, unfortunately, Mr. Secretary, in this particular forum I am allowed to have the last word.

I do think, though, it is curious that one of the most single-most-quoted economists by Democrats is Mark Zandi, who said, "It would not take much more of a pullback by the affluent than an-

anticipated to derail the recovery,” when he advocated not raising taxes on the top two brackets.

In the roughly 45 seconds I assume I have remaining, one of the questions I have you may only be able to respond to in writing.

I understand the Keynesian argument behind the stimulus. I don't agree with it. I think it has been ineffective. You believe that it is effective. We will postpone that debate. Here is what I don't understand. At a time where we are absolutely drowning in debt, where we know that gross debt is now over 90 percent of GDP, that history tells us we could lose economic growth because of this, why in your 10-year budget plan do all you do is extend the deficits, extend the debt in the outyears? Surely you do not believe under your policies we are still going to be mired in this recession 3, 4, 5, 6 years from now? What explains the spending and the doubling of the debt in 5, tripling the debt in 10, debt held by the public?

Secretary GEITHNER. In the spirit of your question, Congressman, you are asking me to go out and borrow \$700 billion from investors around the world to extend tax cuts from President Bush that would expire for 2 percent of the wealthiest Americans in the country. There is no plausible argument that that is a fiscally responsible action for the Government of the United States at this time.

Mr. HENSARLING. Mr. Secretary, you could have reduced spending, and it is going to cost \$2 trillion.

The CHAIRMAN. The gentleman's time—this is the last answer. I don't think I have been tough on time.

Mr. Secretary, conclude your answer, and we will go on to the next one.

Secretary GEITHNER. I was just going to observe that the proposals the President made in his budget would reduce our deficit by more than half as a share of GDP if you join us in approving those proposals over the next 5 years.

The CHAIRMAN. The gentleman from Missouri, the long-suffering gentleman from Missouri. As a minister, he certainly knows how to do that.

Mr. CLEAVER. Thank you, Mr. Chairman.

Thank you for being with us, Mr. Secretary, and thank you for the very difficult job you perform, but it is appreciated.

Let me just start out, in the 1870's, Thomas Edison created a phenomenal little deal called a light bulb, and afterwards we ended up having the creation of a major corporation called General Electric. And we had this unique little creation born here in this country.

At the end of this month, GE will discontinue making incandescent lights and the plants will be closed. This light will not be made anywhere in the United States. There is a reason. The CFLs actually use about 75 percent less electricity. But the negative part of it is that, because it is circular, there is a lot of hand labor involved, and now the United States will import almost all of the CFLs from China, which gives me great pain.

The stimulus also provided some opportunities for the Department of Energy to help companies get involved in green technology.

I mention all that because in your September 16th testimony in the Senate you said, “We are committed to promoting policies in both the United States and China to create new opportunities for

Americans and grow jobs in the United States and we are not leaving these outcomes to chance.” And so I am wondering what—tell me and, hopefully, others—what the Administration is doing that would make certain that we are not leaving this to chance, considering China is probably making some big mistakes. Because as they are underwriting many of the factories that are doing this work and doing big land deals which could conceivably cause them to have a real estate crisis later on. But I am interested in your response.

Secretary GEITHNER. Congressman, a very important question, and I would suggest the following:

It is very important that we do things in the United States that increase incentives for Americans to invest and build things here rather than overseas. And the proposals you referred to, they were in the Recovery Act to provide very substantial incentives for investment in new technologies. Basic science, research, and development in new energy technologies are part of that process. But we are going to have to do a lot more in that context, and it is very important to us for us to recognize that the most important thing we can do for manufacturing in the United States is going to do a better job of improving the incentives for companies to invest here rather than outside the United States.

That is not enough, though. It is very important that our companies face a level playing field around the world, and that is why it is so important that we continue to try to encourage China to let their exchange rate reflect market forces and to end practices that discriminated against U.S. companies. And we are looking for ways to—we are making a little bit of progress, but we have a long way to go on that front. But you have to do both. You have to do both those things. You have to invest more here and make sure we are being as effective we can in making sure other countries are not pursuing policies that put our firms at a disadvantage.

Mr. CLEAVER. Mr. Secretary, thank you for your time and your thoughtful response.

Mr. Chairman, I yield back the balance of my time.

The CHAIRMAN. The gentleman from Delaware, Mr. Castle, is now recognized for 5 minutes.

Mr. CASTLE. Thank you, Mr. Chairman.

And, Mr. Secretary, sort of following along the lines of Mr. Hensarling’s questions, one of the things that I hear about out there—and you do, we all do, I guess—is the lack of certainty with certain of our policies that we do here in Congress, that perhaps the White House does. Tax policy is obviously one. Regulatory policy is another.

We, as you know, had passed legislation involving credit cards, and we had passed other legislation involving banks, etc. To the best of your knowledge—the broad question may be on your testimony here today, but to the best of your knowledge, is the Administration focused on this and perhaps the need to introduce stability to get whatever it is we have to get done and leave it alone and make it permanent so businesses can make decisions based on whatever the laws are and not what they might be 1 or 2 years from now?

Secretary GEITHNER. Absolutely. And that is one reason why we don't think Congress should wait on providing clarity to the tax treatment that is going to be so overwhelmingly important to, again, 97 percent of working Americans and small businesses. And if we can work together to give them additional incentives to invest here, I think it is very important we do that.

It is not rocket science. It doesn't take a lot of time to do. Certainly would be better.

I am very concerned by the extent to which, you talk to businesses and individuals across the country, they think there is some risk Congress won't act to extend those middle-class tax cuts. And that is a remarkable thing. Because it would be a deeply irresponsible act to leave them with uncertainty longer than we need to about what that tax stream is going to be.

On the regulatory front, I can only speak to the issues that are part of the financial reform legislation; and there we have a challenge. These are very complex rules. It is very important that we get them right.

The legislation gives a set of deadlines we have to meet. Those are very tight deadlines, but they still mean for the next—we are going to be in a 6-, 12-, 18-month, 24-month process before we bring those all down to earth. And I think the best way we can provide a little bit more confidence that we are going to get the balance right, like we did in the capital rules, is to make sure we are listening carefully to people on how to design them, everyone affected by them, and try to, again, demonstrate by our actions, like we tried to do on capital, that we are going to get the balance right.

And, again, capital is a good example, and we should hold ourselves to that high standard. When the rules were clarified, that certainty was very helpful. I don't comment on markets ever, but I am just saying if you look at what happened to how the world looked at the financial system when the rules were clarified, they were more confident that they knew what they were going to mean, and our banks are in a very good position to meet them.

But that is a high standard. We are going to try to meet that. And I absolutely agree with you that bringing more certainty to what these new rules are going to be would be very helpful. We will do it as quickly as we can.

Mr. CASTLE. I met with Senator Carper and our bankers in my State, Delaware. And one of their complaints was that the various—they have varying regulators, obviously. But one of the regulators is being so restrictive in the kinds of loans that they can make that they can't really help the economy as much as they would like. They claim that they are making loans and the regulators—and they have made their cuts because they knew they had to do this. And then the regulators are coming in and saying you have to really go further than you have already gone, and it is really restricting them in terms of what they can do.

I can't—I have no idea of the accuracy of that statement, but it is concerning. If we are somehow by our own regulatory policies, etc., cutting off the possibility of investments that might help our economy recover, that would be a problem. I am sure you have probably heard this complaint. Any comments you have about that I would appreciate.

Secretary GEITHNER. I have heard that concern from banks across the country as have you and your colleagues. And I know that Chairman Bernanke and Chairman Bair and the OCC are very aware of those concerns, and they are trying to make sure that their supervisors or examiners don't overdo it.

But the biggest challenges facing small banks across the country still are that many of those banks got themselves too exposed to commercial real estate, just don't have quite enough capital, and are finding it hard to raise capital in these markets. That is still a much more powerful concern for most of those banks than the concern you referred to, and that is one reason why we hope this bill gets through.

Because what this bill will do is give those banks the ability to come to the Treasury and get an investment from the Treasury at a very economically attractive price. And if they expand lending, we reduce their dividends even lower, so it creates more incentive for them to put that capital to work to expand lending, and that is why we think it is such a promising bill.

Mr. CASTLE. A final question—and I missed the beginning because I was at other meetings—but did you comment or would you comment, if you didn't, on where we are with the GSEs? I know that you are working on it, and I know we are going to hear something pretty soon. I still believe that was the genesis of a lot of our problems.

Secretary GEITHNER. You are absolutely right that the GSEs were a substantial contributor to the financial crisis. And as you all are aware, the losses they accumulated and the decisions they made before conservatorship are very substantial. We have begun a process, as has this committee, to look at a range of options for how to replace the institutions with a better, more stable system. And we are running a very careful process of bringing experts together and looking at ideas on all sides. A bunch of staff members from the Republican side and the Democratic side came to a conference we held at the Treasury last month on this.

And, again, we are trying to make sure we look at all ideas with no presumption on it. And our obligation under the law is to bring forward legislation, I think, Mr. Chairman, early next year. In any case, that is the timeline we expect to meet.

Mr. CASTLE. Thank you, Mr. Secretary.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

Thank you for being here, Secretary Geithner.

You and I have disagreed a bit about whether or not government should basically deny or discontinue certain risky products. You have said to me many times you believe that you manage those, you regulate, but you don't use the power of the government to discontinue products. Do you still feel that way?

Secretary GEITHNER. I believe that there are certain practices, activities—I will give you an example. Paying a mortgage broker to steer a customer into a loan they can't afford that generates more fees in the short term is not a practice we should support or condone. But I think the best way to manage the risks in financial innovation in a market financial system is to make sure that we

require institutions to hold more capital against the more complex financial products. And I still believe that is a more effective approach.

Ms. WATERS. I am sorry. If I may, I see that where you basically talk about banks will be required to hold more capital against more risky products and activities. But what I am concerned about is whether or not you think Alt-A or no documentation loans are something that you should hold more capital against that kind of risk when you are not documenting income, etc., etc. Why should that product be on the market in the first place?

Secretary GEITHNER. I believe it is very important—and the law gives us new authority and a mandate to do this—to make sure that banks, when they make loans to people, have to be able to demonstrate that the individual can afford those loans when—their capacity to pay, and I think that is very important. And if we do a better job at that as a country, it is inconceivable to me that we will get back into the business of letting people get a loan with no documentation, no proof of income.

Ms. WATERS. Mr. Secretary, have you ever heard of a 30-year fixed adjustable rate mortgage?

Secretary GEITHNER. I have, and I find them appealing in their simplicity in terms of their terms and benefits.

Ms. WATERS. A 30-year fixed adjustable rate mortgage is a contradiction within itself. That is number one.

Number two, if there is something called a 30-year fixed adjustable rate mortgage that is marketed to a 60-year old couple where it will reset every year up to 10 percent interest and by the time they are 75 or 80 years old, it will be substantially more than what they got into it for, do you think that is a decent product?

Secretary GEITHNER. I misspoke. I thought you meant just a classic 30-year fixed rate.

Ms. WATERS. No. I said 30-year fixed adjustable rate mortgage that is being marketed. And I use that as an example of products that are on the market that should not be on the market. There should not be anything called a 30-year fixed adjustable. It is a contradiction.

Secretary GEITHNER. Having listened to you more carefully, I apologize. I understand your concern completely, and personally, I would not want to be associated with anything like that. I think that is the kind of practice that should not be possible in our post-reform financial system.

Again, it should not be possible for banks or brokers to steer people into mortgages that they cannot understand and cannot afford. It was a mistake for us to allow it, and I think this new law gives us the power to prevent it.

Ms. WATERS. Thank you very much.

Mr. Secretary, let me just say this: You keep talking about steering. They should not be steered into that kind of product. That kind of product should not exist. It is not that the product is all right as long as people are not steered into it who can't afford it, that product, Alt-A product, certain adjustable rate products; and I am hopeful that our Consumer Protection Financial Bureau will be able to get the kind of support from you and others that will take those kind of products off the market.

So I keep asking you this every time I see you, because I am hoping you are going to change your mind, and you are going to find that there is just some product out there that you would ban tomorrow if you had the power to do it.

The CHAIRMAN. Will the gentlewoman yield?

Ms. WATERS. Yes.

The CHAIRMAN. I do believe with regard—while there is not a general power in the consumer bureau to do this, the mortgage section is a more specific section. And I believe that the mortgage—in the mortgage area, for instance, with prepayments, etc., there is the power to ban certain products if mortgages—that they have a greater power in the mortgage area than in other areas.

Ms. WATERS. I certainly hope that Ms. Warren will get that kind of support.

And, finally, if I could indulge for 30 seconds, Mr. Chairman.

The CHAIRMAN. Certainly.

Ms. WATERS. There is something in the Wall Street reform bill called the creation of the offices of minority and women inclusion. Are you aware of it?

Secretary GEITHNER. Absolutely.

Ms. WATERS. And have you started your agency on the implementation?

Secretary GEITHNER. We have started, but we are not there yet.

Ms. WATERS. And you know you have to have it done in 6 months?

Secretary GEITHNER. I do.

Ms. WATERS. And you know that some of us have worked very hard to put it in there?

Secretary GEITHNER. I do, and I very much respect the reasons why you did it.

Ms. WATERS. Okay. Thank you very much. I yield back.

The CHAIRMAN. The gentleman from New York, Mr. Lee.

Mr. LEE. Thank you; and, Mr. Secretary, thank you for coming before us today.

I wanted to start off by addressing two issues which are near and dear to me based on my background in manufacturing and in seeing what has transpired with manufacturing in this country over the last decade and its demise. I know last week you were in front of the House Ways and Means Committee regarding the undervaluing of Chinese currency. And you expressed concern similar to that of the U.S. Trade Rep that the currency reform for fair trade is not a viable option because of a belief that it may not be WTO compliant.

At the same time you said, “The Administration is using all the tools available to ensure that American firms and workers can trade and compete fairly with China.”

It has been apparent for years that China’s currency is pegged to the U.S. dollar and it is severely undervalued, yet the Administration refuses to officially list China as a currency manipulator and, based on yours and Ambassador Kirk’s statement, also refuse to discuss a legislative option. Mr. Secretary, if these issues are off the table, I would like to know specifically what the Administration is doing to address our disparity with China and create a level playing field for American manufacturers who are hurting.

Secretary GEITHNER. Can I just clarify one thing you said? I actually was very careful last week not to comment on the basic question about whether that particular draft legislation was consistent with our international obligations. You implied that I said it wasn't, but I did not say that.

We obviously want to make sure that any legislation that is passed is consistent with our obligations. Because, if it weren't, it wouldn't give us much leverage to go after those things.

I believe, as I said last week, the two most important things for us to do as a country are to work with countries around the world to encourage countries—China to let their exchange rate appreciate in response to market forces, which we are working very hard at doing. They are starting that process, but they haven't done much very yet.

Mr. LEE. At a very anemic level.

Secretary GEITHNER. I agree, and I said that very clearly last week. And we believe, as I think you do, that the exchange rate is significantly undervalued.

Mr. LEE. As we say, we can't dictate what they pay their workers, what their regulation is. But when you are talking about something as basic as market forces with currency, a 30 to 40 percent disadvantage is killing American manufacturing.

Secretary GEITHNER. I think it has a very substantial adverse material effect on our economy and our interest, but that is not enough, and I want to make it clear on this.

In addition—and this is a real problem for us—we face a number of practices by the Chinese government that do discriminate against American producers in the United States and those who operate in China, and we are trying to encourage them to end those basic practices, and we want to do both.

Mr. LEE. And I think we should. Because if we keep kicking the can down the road for a few more years, we will not have manufacturing in this country as we know it today.

I just want to switch to something else, because I know I have limited time. But it is another issue that, again, is very important to me based on having a lot of retirees in my district.

Last year, I spoke to you during one of your visits to our panel and asked your thoughts on the inequitable treatment of pensioners for more than 20,000 Delphi salaried retirees, the majority of which suffered significant cuts in their pension during the restructuring of GM and the Treasury's Auto Task Force. You replied that your team would sit down with me and provide answers as to why these salaried workers were treated differently than the hourly retirees when pensions were topped up, presumably with TARP funds provided by taxpayers.

To date, despite multiple requests directly to you, the Auto Task Force, and the President, I have not received any substantive reply to my request.

I have now tried a different avenue and have secured official investigations through SIGTARP and the GAO, but, frankly, I would like to try one more time to hear from you, Mr. Secretary, exactly why the Administration, your Department, is refusing to make public all the documents concerning how unfair and unjustified this decision has been?

Secretary GEITHNER. Absolutely. We will work with you and the range of bodies that oversee these programs to make sure they have all the information to reach those judgments. And I will reaffirm my commitment to you to have those people come up and meet with you and your staff to talk through this very complicated, very difficult problem.

Mr. LEE. And I will take you at your word on that. Because this is something we have now been working on for 18 months, and we have a lot of retirees who have been drastically impacted. I meet with them on a regular basis, and it boils down to fairness, period. All they are looking for is to be treated as—if they had to take a haircut, let's do this thing equally. But it appears that they have really been singled out, and I will hold you to that.

And with that, I will yield back.

The CHAIRMAN. Will the gentleman yield?

I would just add, Mr. Secretary, I just received a letter from three of our colleagues—Senator Sherrod Brown and Representatives Charlie Wilson and Tim Ryan—on that identical issue. So I would agree, of course. They asked for something similar, and I am going to have them join with Mr. Lee, and we will work on that.

The other thing, I just wanted to clarify that we have gotten an answer, which is, under the consumer bill that was passed, there is a particular section on mortgages, and there is greater power on mortgages than in general; and the product that the gentleman from California mentioned could, in fact, be banned under that special mortgage power.

The gentleman from Illinois.

Mr. FOSTER. Thank you, Mr. Chairman.

I guess, I would like to start out by asking for recognition that the sufferings of a scientist are no less than those of a minister when you listen to this politicized debate here. Anyway, also, but actually—

The CHAIRMAN. If the gentleman would yield? I will give you back your time.

He got me backwards. I said the minister could bear it more easily. No question, you are more impatient. I will give you that.

Mr. FOSTER. But, also, as someone who started a manufacturing firm myself, I would like to associate myself with the comments of my Republican colleague there. The Chinese currency manipulation is a fundamental problem that has to be fixed and fast. You are going to find lots of friends on both sides of the aisle for pushing you, and if there is a role for Congress in playing bad cop in this, we are happy to play that role.

Let's see, a couple—actually, one quick historical comment on the ultimate cost of TARP which you mentioned. And it is interesting to compare that to the ultimate taxpayer cost of the savings and loan bailout that happened under the Bush—the Bush I and Reagan years, which was \$160 billion of 1990 dollars or about 3.2 percent of GDP. The numbers you just quoted—which I had not heard yet—were \$66 billion, or less than half a percent of GDP. So expressed as a fraction of GDP the ultimate taxpayer cost of this emergency intervention will be about one-fifth that of the savings and loan bailout, which is a very interesting comparison.

Now, the question I had, there had been recent stories in the press about the toxic assets and whether or not they have actually cleared. And so my question to you is, at the time that the Basel requirements actually take hold—first off, are these continuing to do damage on the balance sheets of financial firms and will that damage largely have cleared by the time the Basel stuff kicks in?

Secretary GEITHNER. I do not believe—let me say it in the affirmative way. Because of what we did in the early stage of 2009, the major U.S. banks that account for a substantial fraction of banking assets in the country now hold very, very substantial levels of capital against the risks that they retain on their balance sheet. So I do not believe that those potential losses now are a material source of risk to the recovery or the stability of those institutions, and that is a remarkably important accomplishment.

Now, it is still true that community banks across the country that got themselves exposed to commercial real estate are still facing really tough, tough problems, and they have a long way to go to work through that. And for some of them it is harder to raise capital, again, which is one of the reasons why this small business lending program is so important.

Mr. FOSTER. In regards to Basel, are there requirements in the pipeline having to do with institutionalized stress tests, standards for risk management treatment of sovereign debt risk in the standards?

Secretary GEITHNER. It is our view—and I am not sure I can speak with the right degree of precision about what the law requires and what the consensus in Basel is at this stage, but I think it is very important for supervisors around the world on a regular basis to conduct stress tests that try to capture the potential risk of loss that banks might face in the future recession, and that is a very good test over time about whether the capital requirements that are in place are actually delivering enough capital over time. So I am very much in favor of that and will work to make sure we do that on a regular basis going forward.

Mr. FOSTER. They must be standardized. If they end up being what drives the capital structure of these large financial firms, they are as important as the basic Basel formulas.

Secretary GEITHNER. They should be standardized in the sense that they need to capture a crisis with the same level of severity and loss. In that sense, I totally agree with you.

Mr. FOSTER. And can you say a little bit about the state of play of contingent capital a little more?

Secretary GEITHNER. I would say it this way, which is there is still tremendous appeal to us in designing a form of continuing capital that would, again, make the overall banking system less prone to periods of mania, euphoria, and less prone to panics and the trend-amplifying margin spiral dynamics and deleveraging you see in a crisis. We are looking at and there is a group of experts in the United States and around the world that are looking at a whole range of ideas of how to design those instruments in ways that would work.

And you have thought a lot about this, and I respect very much your views on this and happy to talk about in more detail elsewhere, but the problem we find is how you design it in a way that

would be real, really available in a crisis, not be punitively expensive, and not come with the risk that you have to require the uncertain judgment of officials, bureaucrats, around the world to trigger their—

Now there are ways around those problems, but we haven't found the perfect thing yet.

Mr. FOSTER. Thank you. I yield back.

Ms. WATERS. [presiding] Mr. Lance.

Mr. LANCE. Thank you, Madam Chairwoman.

Good afternoon, Mr. Secretary.

You have certainly given us your position, Mr. Secretary, on the tax cuts. My position is that they should be extended for all tax brackets. I believe we agree, however, that certainty is required.

Mr. Hensarling has raised this, Mr. Castle, and I raise it again. In the Administration's judgment, when should we engage in certainty on the tax cut issue? In other words, should we do that now while we are still in session or should we wait until after the election to the lame duck session of Congress?

Secretary GEITHNER. That is really a question for the leadership on both the Democratic and Republican side.

Mr. LANCE. And I think it is a question of the Administration. Does the President, and do you as Secretary of the Treasury, have a position on that?

Secretary GEITHNER. My view, as I said many times, and the President said this, that since there is very broad agreement on the merits of extending the middle-class tax cuts that, again, go to 98 percent of working Americans and small businesses, that why not act to extend those as soon as we can. And we can still have a debate about what to do about the rest of them, but why hold those hostage to the debate we have to have, again, on whether it makes sense for us to go out and borrow \$700 billion to add to our deficit to extend those high-income tax cuts?

Mr. LANCE. So could you be a little more definite in what you believe the time period should be?

Secretary GEITHNER. Not on the legislative question. Again, that is a question where the leadership of both Houses on both sides would have to come to a judgment.

Mr. LANCE. Regarding your indication of your belief of borrowing \$700 billion for the top two brackets, what percentage of income is that? You indicate 2 or 3 percent of taxpayers. What percentage of total income is that?

Secretary GEITHNER. Obviously, it is a larger share of total income. But the right way to think about it economically I think is to look at the overall effects on the economy relative to GDP of extending them. And I think there are—

Mr. LANCE. What percentage of income is it, do you know?

Secretary GEITHNER. It would be a very small fraction of GDP, which is overall national income. But I think the right way to think about it, if I could say, is that I think it is very hard to find an economist that would argue that if the economy needs more support and we are a country with not infinite resources that that is the best use—

Mr. LANCE. Mr. Orszag, your former colleague, has indicated he favors extending all of the tax cuts for 2 years.

Secretary GEITHNER. First of all, I can't—I won't speak to his opinion. But our view is that the best thing to do for the country is to extend those tax cuts for middle-class Americans and small businesses as quickly as we can. And if we believe the economy needs additional reinforcement, as we do, then let's find a way to give additional incentives to businesses to invest here in the United States. Let's do that as soon as we can.

Mr. LANCE. Thank you.

Madam Chairwoman, is it permissible for me to place in the record the op-ed piece of Mr. Orszag that was in the New York Times on this issue?

Ms. WATERS. Without objection, it is so ordered.

Mr. LANCE. Thank you.

In another area, Mr. Secretary, Professor Warren has been named an Assistant to the President. I understand that. Is she technically a person who is on the staff of the White House or on your staff, Mr. Secretary, or on the staff of both the White House and the Department of the Treasury?

Secretary GEITHNER. She is an advisor to the Secretary of the Treasury. Her office is in the Treasury. But she is also—has the additional title as Assistant to the President.

Mr. LANCE. So, sir, does she report to you or to the President or to both of you?

Secretary GEITHNER. As the dual title implies, and as the President made clear, she reports to the Secretary of the Treasury and the President of the United States.

Mr. LANCE. And do you favor an early appointment of a Director so that appointment might go appropriately before the Senate?

Secretary GEITHNER. I do and it will.

Mr. LANCE. And could you define with a little greater precision what your definition of "early" might be?

Secretary GEITHNER. Early in the sense that I think it is the best interest of getting this agency up and running to have a confirmed Director in place as soon as we can.

Mr. LANCE. During this session of Congress or would it be in the next session of Congress?

Secretary GEITHNER. Again, that is sort of a question for the leadership. But, as I said, I think early would be good.

Mr. LANCE. I think it is a question for the President and the Administration, since it is the President who has the constitutional responsibility to appoint the Director.

Secretary GEITHNER. He does, and he will meet that responsibility.

Mr. LANCE. At an early date?

Secretary GEITHNER. At an early date.

Mr. LANCE. Thank you.

Madam Chairwoman, I yield back the balance of my time.

Ms. WATERS. Thank you very much.

Mr. Watt.

Mr. WATT. Thank you, Madam Chairwoman.

Thank you for being here. I am sorry I didn't have the benefit of your testimony or the prior questions.

Is there still a shadow banking system out there that we need to be concerned about that is still not appropriately regulated?

Secretary GEITHNER. It is a shadow of its former self, but yes, there are still institutions that are not legally banks that operate in the credit markets, financial markets, and play a significant role. And part of one of the most important initial tasks we have under the Dodd-Frank bill is to designate what universe of institutions should be subject to the capital requirements we are discussing in this hearing today.

Mr. WATT. So that shadow banking system will continue in place until we get those rules in place, is that what you are saying?

Secretary GEITHNER. Yes. One of the most important provisions of this bill is it gives us the authority for the first time to make sure that for institutions that play a critical role in our financial system, whatever you call them, banks or nonbanks or investment banks, that they come into a common framework of rules on leverage so we protect the system from their risks.

Mr. WATT. I think I am driving at a slightly different issue that some of the minority members of this committee, racial minority members of the committee tried to raise this. There are some shadow institutions in our communities that have a profound impact on what is going on in our communities that don't have a systemic impact on the system. Those are the ones that I am asking the question about. Have we done enough in this bill to rein in or regulate those institutions that don't necessarily have systemic risk to bring down the whole system but still prey on communities, prey on consumers, who really have very few options for credit or transfer of money in, at least they perceive, in the regular banking system?

Secretary GEITHNER. Apologies for misunderstanding your question.

Absolutely. What the bill does is give us the authority for the first time to make sure that basic protections consumers need to borrow responsibly are extended not just to banks but to consumer finance companies or mortgage brokers to pay the lenders.

Mr. WATT. Now, who will have the primary responsibility for that? Will that be the Consumer Financial Protection Bureau or some other agency?

Secretary GEITHNER. The Consumer Financial Protection Bureau will be the single Federal entity charged with that responsibility. But their work will have to be reinforced at the State level by the State authorities whom we expect have to play a key role in enforcing these rules on a range of, let's call them, consumer credit finance companies.

Mr. WATT. So with respect to those kinds of entities, you envision that the Consumer Financial Protection Bureau will be playing the same kind of regulatory role that the other regulators are playing with respect to the traditionally regulated institutions. Is that what you are saying?

Secretary GEITHNER. Yes. And, actually, the way the division of labor in the bill is designed is for the large banks in the country and for the nonbank institutions you are referring to—the Consumer Protection Agency will have the primary enforcement authority. For small banks—

Mr. WATT. Let me ask one more question. Is there the risk of a shadow banking system internationally, and how will that be regulated?

Secretary GEITHNER. There is always a risk that countries will seek to build a financial business by attracting business with the promise of lower standards. And we will have to work very hard to reduce their opportunities to do that like we do in the tax area, like we have done, as the chairman referred to initially, in the broad area of terrorism finance, and we are going to have to do it in the financial area as well.

Mr. WATT. Is Basel focused on that at all?

Secretary GEITHNER. Absolutely. And the Basel Committee has around the table countries that represent, I think, more than 85 percent of GDP around the world. That still leaves some people outside that process, but we want to extend the rules to them as well.

Mr. WATT. Thank you.

Ms. WATERS. Thank you.

Mr. Paulsen.

Mr. PAULSEN. Thank you. Mr. Secretary, I want to touch on two subjects. First, we have had a lot of discussion about taxes and jobs and getting the economy back. But can I just touch quickly on the free trade agreements? The President has made it his goal to double exports in the next 5 years, and in light of that goal, can you explain a little more forcefully why the Administration hasn't encouraged at least more forcefully the majority party here to act on some of the pending free trade agreements that we have right now that will increase exports and produce jobs? I know there has been some progress on South Korea, but Europe has moved in the direction now and has already come to an agreement with South Korea. I am just wondering, sir, when will this hurdle actually move forward?

Secretary GEITHNER. I agree with you, and the President agrees with you, that one of the most important things we can do to expand exports and increase jobs in this country is to make sure we are playing a major role in those growing markets. And, as you know, the President, in June, committed to bring to conclusion the free trade agreement with Korea so that he can present it to the Congress, we hope, by the end of this year. And to make that possible, of course, we have to demonstrate this is an agreement that is a good deal for Americans; and we need to find a way to get enough support in this body and in the Congress that we can actually pass it. But it is very important to us as a country that we don't leave those markets to our competitors.

Mr. PAULSEN. So it would be your opinion, Mr. Secretary, that the ratification of those pending agreements would create jobs and would help?

Secretary GEITHNER. Can I say it slightly differently? We have to make sure that we have agreements in place that provide a good deal for American businesses and American workers. So where we have strong agreements that meet that test it will be very important to us to make them law.

Mr. PAULSEN. I want to follow back up, because—the Basel discussion earlier on the capital standards, I want to ask a question just about capital formation. The financial reform bill that is now law changed the net worth test for meeting the accredited investor standard. I am just wondering, did you support those changes? Do

you believe that altering the accredited investor standard will impact the ability now of entrepreneurs to raise capital and take their companies public, some of those standard changes?

Secretary GEITHNER. You are testing my memory of the origin of that provision, and I will be happy to look at it in more detail and get back to you.

But my general view—and I think it is supported by how the broader financial markets and the investment community had reacted to this bill—is that this will provide a better system for companies to go raise capital and a better system—a better way for us to make sure that the entrepreneurs in the future, businesses in the future, can go out and raise capital at attractive terms.

Mr. PAULSEN. I just spent some time talking with some of these folks who do this private investing; and they include the assets of their home, etc., as a part of meeting the accredited investor standard. And with the changes that have occurred there is a concern that they are not going to have the liquidity to actually provide—and they have invested in companies. They have helped create companies that have actually provided job growth. And that is, again, part of that uncertainty equation out there, which is why I raise that.

Secretary GEITHNER. I would be happy again to ask my colleagues to take a closer look at the potential impacts of that provision. Because I think we share the same objective, which is we want to make sure that—we want to make our system more stable, because we saw how devastating it is when it is not. But we also want to make sure that it goes back to the business of providing ability for people to raise capital on appropriate terms.

Mr. PAULSEN. And without that access to capital, of course, business slows. Without a regulatory certainty, capital disappears.

I guess in November of this year, I think it is November 18th, the SEC is going to convene some sort of a gathering of a 2010 government finance forum on small business capital formation. And in advance of that meeting can you tell us or describe whether you believe that a small company should be subject to the same regulatory demands that a Fortune 500 company, for instance, might be required to shoulder as a part of the discussion that could take place?

Secretary GEITHNER. Can I answer slightly differently? But I would be happy to come back to the broader question.

I believe that small banks should not be subjected to the same basic standards that are necessary for the large systemic institutions; and what we propose is a much tougher set of rules on the large institutions, tough enough that they will be more stable but still competitive but a lower standard of protections for small banks.

Mr. PAULSEN. Thank you, Mr. Secretary. Thank you, Madam Chairwoman.

Ms. WATERS. Thank you.

Mr. Royce, let me just say, the Secretary has to leave—we promised that he can leave about 4:00, so let's see what we can do to help him.

Mr. ROYCE. Thank you, Madam Chairwoman.

I want to go back just for a minute to my colleague's opening argument there about the light bulb. The government didn't invent the light bulb. The private sector did. It was the government's job to protect the patent for the light bulb, and back when it was invented, our government did that pretty effectively. But today, I don't think our government would protect that patent from being duplicated in China; and that is a huge problem.

But, on top of it, back when the private sector was as robust as it was and we hadn't had the growth of government as we have, we had a very different situation than we have today with the massive, massive increase in the size and scope of government with the corresponding shrinking of the private sector. And I don't think it is a particularly enlightened position. I think it is going to leave us in the dark.

I wanted to ask you because from the standpoint of us being the tax collector for the welfare state, do you think it is logical—the comments you made, I think not increasing taxes would be treated the same as government expenditures, all right, under your assumption. Not increasing taxes is the same as government expenditures. Human reaction is not going to be the same. If you increase tax assessments on people to 100 percent, would you get 100 percent of that revenue, do you think.

Secretary GEITHNER. Congressman, it is a very complicated set of issues and I know we are not going to agree on them completely, but I would just start with the following: We do not believe that governments create jobs. Businesses create jobs, and our job as policymakers, people involved in governing, our job is to make sure that we are providing better incentives for businesses to invest here at home and create jobs here in the United States.

Mr. ROYCE. That is right, and one of those issues is tax rates. If we have tax rates, remember, there are taxes on income at the State level and Federal level. If you hike that up over 50 percent, the idea that you are going to get 50 percent, the economic studies I have seen show that maybe the maximum—because when you set the tax rates at 28 percent, maybe about there is when people give it their all in terms of their overtime, in terms what they are willing to risk, in terms of how much they put on the table, in terms of not seeing the tax avoidance issues and you collect more.

But you get up—you hike that rate up over 50 percent as we are going to do next year between the combined State and Federal tax rates, and all of the sudden you diminish the amount of the take. So I just don't buy into your basic thesis that automatically you are going to be able to hike those rates up and see that kind of income. I think it is going to be a lug on the economic engine.

But another concern I had that I wanted to ask about quickly was, Basel III treats many high risk sovereigns as essentially risk free, and I would just ask you, do you think that Italian debt really is risk free? We had the same problem under Basel II with Fannie Mae and Freddie Mac, right? It was treated basically as risk free. It did not turn out that way, and it certainly helped collapse those financial institutions. So I would ask you your opinion on that.

Secretary GEITHNER. I am going to start with the tax question.
Mr. ROYCE. Yes.

Secretary GEITHNER. I just offer two things in response. Obviously, since we can't do everything, we have to balance two basic objectives. We want to have the best incentives for growth and investment in the United States by businesses, by individuals, and we have to find a way to do it in a way that is fiscally responsible.

And if we agree—and I think we do—that our challenge now is to find ways to give more reinforcement to economic growth and investment in the United States, then we should have a debate about how to do that. Again, our judgment is the most responsible way to do that and the biggest, most powerful return for those dollars is to give businesses more incentives to expand investment, not extend the tax cuts that are set to expire for just that top 2 percent of Americans.

But one observation is, of course, marginal tax rates matter for incentives—you are absolutely right—but we have a good experience to look to about the effects of those. And for the period I was last in Treasury, in the late 1990's, when those tax rates were in place at roughly that same level, we had the best record of private investment, the best record of productivity growth, the broadest big gains in income, and we had a remarkable improvement in our fiscal position.

So I believe—

Mr. ROYCE. Even in a recession, you believe in hiking the taxes? Oh, I get it. I get it. But let's go to that last question.

Do you think that Italian debt is risk free, because under Basel III, that is the assumption. That has to be a problem.

Secretary GEITHNER. That is a very important question, and I respect your concern about this, but again, what this—

Ms. WATERS. We are going to have to move on to Mr. Campbell, please, so that we can get the Secretary out.

Mr. ROYCE. For the record, I am going to ask on another issue, on EU regulations regarding alternative investment firms, I am going to ask for some response but you have already been involved in this.

Secretary GEITHNER. Let me say quickly that this new Basel agreement does a much better job of making sure banks hold more risk against products that have risk regardless of what their rating is, and that is very important to us.

Mr. ROYCE. Thank you.

Ms. WATERS. Mr. Campbell.

Mr. CAMPBELL. Thank you, Madam Chairwoman.

Mr. Secretary, I just have one question for you. There are several of us—a bunch of us actually on this committee who are perplexed as to why, given the current interest rate environment, Fannie and Freddie were not selling off some of that portfolio, 106 and 107 cents on the dollar, reducing the taxpayers' exposure, investment, etc.

So we wrote a letter to the Director of FHFA, and in the letter, in part, he says, and I will read just one sentence: "Other than a few limited exceptions, any Enterprise sale of assets not considered ordinary course of business require Treasury consent." Essentially kicking the football to the Treasury, I think, on this.

So I would like to ask you, are you in favor of Fannie and Freddie doing that or against it, and what is the reason for either position?

Secretary GEITHNER. To do justice to this, I probably should respond to you in writing, but I will say the following to you.

Mr. CAMPBELL. I will be happy to address it to you in writing.

Secretary GEITHNER. I hate to invite letters. It is very important to us that we do everything we can to reduce the ultimate losses we are going to face because of the decisions that were made before conservatorship. The basic businesses, beginning today, we believe by any reasonable calculation are going to be very profitable ongoing businesses for the institution, but we will keep looking at ways to make sure we are managing those investments in a way that maximizes the ultimate return to the taxpayer. Beyond that, I don't want to say more in public on it, but I will be happy to try to do it carefully in writing.

Mr. CAMPBELL. Thank you, Mr. Secretary. I yield back.

The CHAIRMAN. The gentleman from New Jersey, I guess, is up.

Mr. GARRETT. You guessed right. So very quickly, on AIFMD, the Alternative Investment Fund Management Directive, my understanding is that they have set up some or at least proposed some proposals that would be protectionist—

Secretary GEITHNER. This is the European directorate?

Mr. GARRETT. Yes. And I also understand some of them are ill-informed from our perspective. I also understand that you wrote to the Commissioner on this a few months back, and I think you also wrote back in March of this year, to express our concern. So a few quick questions on this: what has the response been then; are you still concerned; and are you committed to make sure that U.S. firms have as complete and open access as we are providing to foreign firms?

Secretary GEITHNER. Yes, we are concerned, and yes, we are committed to achieving that outcome. And I guess my basic sense, Congressman, is that they have listened to our concerns. They have acknowledged them. They have moved in some ways, but I do not believe we have solved this to our satisfaction yet.

Mr. GARRETT. But you are still—

Secretary GEITHNER. We are on it.

Mr. GARRETT. Also out of the Commission last week is proposed legislation on regulation of the derivatives market. My understanding there is they are doing it differently than we are doing it. They will not subject the end users to clearing and margin requirements as we see in the Frank-Dodd bill. So couple of questions there, and also I understand some of our regulators here are considering subjecting some end users to, as I call them, bank-like regulation with respect to derivatives that are put in place, as we call it, to manage their risk.

So very quickly, since there is a limited time here, do you believe that our regulators over here have that authority that we hear that they are considering to put in place? And would that be in contravention, if they are, to what that letter from Dodd and Lincoln after the final bill went through, you may recall, expressing the concerns in that area? I will have a quick question on that to follow up.

Secretary GEITHNER. I will tell you what my sense is. It is not clear what the Europeans are going to do yet. I think they have moved very, very close to the broad outlines of what is in the Dodd-Frank bill on derivatives, and we are going to work very hard to make sure that those regimes are as close in design as possible for the obvious reasons that we don't want to just see this stuff migrate over there.

Mr. GARRETT. Right.

Secretary GEITHNER. So we have a team of people at the Federal Reserve, the SEC, and the CFTC that are not just working on designing our regs but are working with their counterparts to try to make sure that these different oversight frameworks are as closely aligned as possible.

Mr. GARRETT. And if that doesn't happen to the extent you are satisfied with, does that put us then at a competitive disadvantage? And the other question also I previously asked was with regard to, do you believe that our regulators here have the authority in essence to put margin requirements on all end users?

Secretary GEITHNER. I want to respond to that specific question in writing because I want to make sure I do it carefully, and it is a very complicated question.

On this first question, if we end up with a system where it puts our firms at a disadvantage, how can we reduce that risk, I am actually very confident we can reduce that risk. But we are not at the point yet where we know with confidence how it is going to come out, but we are very focused on it, and it is very important to us again that these things are as closely aligned as possible because again we just don't want to create a new arbitrage opportunity for people to evade the tougher rules here.

Mr. GARRETT. Seeing I have time left, going back to the issue with CFCB and Elizabeth Warren, I think what we heard here in this committee, oddly enough during the creation of the bill and the CFCB, that constitutional evasion was part and parcel of the drafting of the bill. By that, I mean the chairman said we understood this thing would not be set up—confirmation would not be done for some time, and so therefore, his comment was made we want to make sure that it would function before the Senate made those appointments, which I think might be just trying to skirt the issue.

The CHAIRMAN. Would the gentleman yield?

Mr. GARRETT. Sure.

The CHAIRMAN. That was the ranking member who said the Senate made these appointments. The Senate does not make appointments. But I never said before the Senate made the appointments.

Mr. GARRETT. Reclaiming my time, what the chairman did say was you want to have this function before the appointments are approved by the Senate, which basically as I said is, in essence, trying to evade the constitutional requirements which seem to be part and parcel of the discussion in crafting of the bill.

But specifically, as to where we are right now, you talked about executive privilege and you talked about Ms. Warren being compelled to testify. Thank you for that. Does she have to comply with the Administrative Procedures Act?

Secretary GEITHNER. I will talk to our lawyers about that, but I guess my basic sense is, of course, but I am not a lawyer.

Mr. GARRETT. Get back to me? Is her appointment right now to both positions a violation of the Vacancies Act, to have someone running the CFCB without nominating them and subjecting them to Senate confirmation?

Secretary GEITHNER. I do not believe so, but again, I would be happy to respond to that in writing. But maybe I could respond, Mr. Chairman, just more generally on this.

The law, carefully crafted, I know there is a lot of concern about it, but carefully crafted, gives us a set of authorities for trying to improve consumer protection. We don't have authorities Congress didn't give us. We will use those authorities carefully, but it is important to recognize that most of that consolidation of authority only happens when there is a transfer date established, which we have now set for next July, and the additional authorities that don't come then only come when there is a confirmed Director in place. So it is substantially in our interest and I think in the interest of the Congress for us to have a confirmed Director in place as soon as we can, but of course we can only nominate and we need the consent of the Senate for that to happen.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Florida.

Mr. POSEY. Thank you, Mr. Chairman. Thank you for coming, Mr. Secretary.

When we had the regulators in here, we asked them about common sense without forbearance, and they were all about that, but what they told us and what is going on in Florida right now are not the same. Regulators will mark down a performing loan because they don't think you should be able to make it. The evidence of a performing loan used to be whether or not it is performing. Now it is whether or not in the examiner's wildest imagination it shouldn't be performing. I hope you can have some input on that in your position.

Secretary GEITHNER. I would like nothing better. Let me just to say to you that I agree it is still a problem. It is a hard problem to fix because people's tendency is to overreact in a crisis like this because they want to be careful, but if they overdo it, it is a problem.

Mr. POSEY. One question I have is whether or not you agree with academics who claim the recession is over.

Secretary GEITHNER. I am not an economist, and I am not an academic, and I would just say the following: This is still a very tough economy. Absolutely.

Mr. POSEY. I know, but you are supposed to be the smartest guy in the Nation on that subject.

Secretary GEITHNER. Not a chance.

Mr. POSEY. And if you don't know, nobody knows. Do you think we have bottomed out? Do you think the recession is over?

Secretary GEITHNER. I would say the following, which is the best measures we have of how the economy is performing today tell the following story. We have now been growing, the economy has been growing, incomes have been growing now for more than 12 months. The private sector, not the government, the private sector has been creating jobs.

Mr. POSEY. Please just tell me yes or no, to the best of your knowledge, swag it, don't be afraid. Just say, I think it is over or I don't think it is over. That is all I want to know.

Secretary GEITHNER. I am very confident, absolutely very confident, that this economy is on a path to a gradual steady improvement in economic growth that will—

Mr. POSEY. I think we all are. If we don't bust, we will recover in a year, 2 years, 3 years, 4 years, 5 years—

Secretary GEITHNER. You are asking me—

The CHAIRMAN. It is the gentleman's time. If he wants to talk, he can talk. The Chair will listen. The gentleman may talk.

Mr. POSEY. Thank you, Mr. Chairman. I was just hoping that you would shock a bunch of people and man up and say yes or no.

Secretary GEITHNER. I just don't—I just think the question about what economists think about recessions is—

Mr. POSEY. Forget what economists think. I want to know what you think. I know what the retired people in my district think. I know what the working people in my district think. I know what the husbands and wives, what they think, but I want to know what you think. You are the Secretary of the Treasury. Do you think we are out of the recession? Do you agree with the academics or not?

Secretary GEITHNER. I think we are in agreement, Congressman, that this is still a very tough economy, and we are still living with the deep scars caused by this crisis, absolutely, and we have a lot of work to do to repair that damage. I think we are agreeing, not disagreeing.

Mr. POSEY. It is just such incredible effort just to get a yes or no out of anybody in Washington. I think that is what frustrates the public, that is what makes the public distrust us more. Again, you are the highest authority in the land on this right now, and I just asked you what time it is, and you want to describe a clock. Just say, yes, I think we are out of it, I agree with the academics; or no, I don't think we are out of it.

Secretary GEITHNER. We are absolutely out of the worst stage, worst, most gravest, most severe, most at risk point of this crisis, absolutely, absolutely.

Mr. POSEY. We are getting warmer. Go ahead, Mr. Chairman.

The CHAIRMAN. Would the gentleman yield? I just want to say I obviously took the gentleman's time and I will give him extra time. But I am disappointed that you would pursue it in that fashion. The gentleman from Texas asked some questions and we had some thoughtful debate. I would hope that we could have a serious economic discussion, not play "gotcha."

The gentleman can have extra time if he wants to respond.

Mr. POSEY. This isn't a "gotcha," Mr. Chairman. I get asked by my people back home every day, when are we going to get out of the recession; what do you think about the recession? I am asking the person that I think would be the foremost authority—

The CHAIRMAN. He is trying to give you a thoughtful answer. If you didn't like the answer, that is one thing, but he wasn't evading the question.

Mr. POSEY. Listen, if I ask you a question that is a yes or no question, and you want to dance and just say—the honest approach is to say, "I am going to refuse to answer the question."

The CHAIRMAN. If the gentleman would yield, what if they say that is not a very thoughtful question; that is a question which takes categories that I don't think are realistic and that excludes the ability to give a good answer. The National Bureau of Economic Research is a private group; it is not the government. If the gentleman has a quarrel with them, he ought to write them a letter.

Mr. POSEY. They have an opinion, I have an opinion, I am sure you have an opinion. I was just wondering what the Secretary's opinion is. There is nothing diabolical, sinful, mean, evil, wicked, nasty, partisan about that. I just wonder if he personally believes, like the academics do, that the recession is over or if he doesn't agree with the academics, that it is not over. This is supposed to be the smartest guy in the world and he is not answering a simple question.

The CHAIRMAN. If the gentleman would yield, that is kind of an interesting concept. It is an insult by excessive compliment. The Secretary has never claimed that. The gentleman can have as much time as he wants, but I am disappointed that he takes that tone. He has never claimed that. He is a very thoughtful guy, but that kind of denigration by hyper compliment I don't think advances the discussion.

Mr. POSEY. Mr. Chairman, it is not a hyper compliment. It is sincere. My question is sincere. There is no ulterior motive.

The CHAIRMAN. Does the gentleman sincerely believes he is the smartest man in the world?

Mr. POSEY. I beg your pardon?

The CHAIRMAN. Does the gentleman sincerely believe that the Secretary of the Treasury is the smartest man in the world?

Mr. POSEY. On this subject.

The CHAIRMAN. Oh, you didn't say that.

Mr. POSEY. On this subject, I sure hope he is.

The CHAIRMAN. But see, that is the problem with yes and no. On this subject, I didn't get a yes and no when I asked you—

Mr. POSEY. How about that, yes.

The CHAIRMAN. I asked you if you believed he was the smartest man in the world and you didn't give me a yes or no. You said on this subject.

Mr. POSEY. I will tell you yes, right now. He is the second smartest man in the world. You have to be the smartest.

The CHAIRMAN. No, I would say I might have been, but not after engaging in this conversation. No one would think I was very bright. Time has expired. The hearing is over.

[Whereupon, at 4:20 p.m., the hearing was adjourned.]

A P P E N D I X

September 22, 2010

Financial Services Committee

Hearing on “The State of the International Financial System, Including International Regulatory Issues Relevant to the Implementation of the Dodd-Frank Act”

Statement by Rep. Maxine Waters

September 22, 2010

I would like to thank the Chairman for organizing this hearing and welcome Secretary Geithner back to our committee. Thank you for taking the time to come and testify today on “The State of the International Financial System, Including International Regulatory Issues Relevant to the Implementation of the Dodd-Frank Act.”

I know this hearing will be focused primarily on international banking regulations and global capital standards. However, I would like to take this time to focus on a little known but very important provision of the Dodd-Frank Act: **the extractive industries transparency requirement**. This provision requires all companies registered with the Securities and Exchange Commission (SEC) to disclose, in their filings, what they pay to foreign governments for extracting oil, natural gas, and minerals. The data must be disclosed on a country-by-country basis so that payments to individual countries can be tracked in a transparent manner. This provision was based on the bipartisan Cardin-Lugar Amendment, which was proposed in the Senate, and it is similar to the Extractive Industries Transparency Disclosure Act (H.R. 6066 in the 110th Congress), which was introduced by Chairman Frank and which I cosponsored.

Throughout my career, I have taken an active interest in the countries and peoples of Africa, and I have noted with dismay that many African countries are desperately poor countries despite being rich in oil, gas, or mineral resources. A country’s mineral wealth should be a blessing to its people. But in the absence of transparency, mineral wealth can contribute to corruption, dictatorship, and armed conflict.

In the most egregious of cases, profits from mineral sales have been used by authoritarian governments to purchase arms to repress their citizens or by paramilitary groups to fund violent conflict. Sudan is rich in oil, and its government uses the oil revenues to purchase weapons and military equipment, while committing genocide against the Sudanese people. Rebel groups in the Democratic Republic of Congo have used mineral wealth to purchase weapons and terrorize civilians. Liberia and Sierra Leone are both rich in diamonds, and both countries are recovering from brutal civil wars that were funded in part by diamond-mining activities.

Even in the absence of armed conflict, billions of dollars that belong to the citizens of resource-rich developing countries are lost due to corruption. Too often, revenues from royalties paid by multinational corporations for the right to extract natural resources end up in the pockets of corrupt public officials. Africa alone has lost billions of dollars over the last 30 years to dictators who have sold oil and mineral extraction rights and stashed the earnings in foreign accounts.

These revenues should be spent on critical development priorities, such as health care, basic education, clean water, infrastructure, and poverty-reduction programs.

Some developing countries have pledged to disclose their revenues from extractive industries. These countries require government agencies and public officials to disclose all royalty payments in an effort to weed out corruption. However, without corresponding data from the oil, gas and mining companies themselves, it is difficult to verify the accuracy of the officials' disclosures. Public disclosure of payments to foreign governments by oil, gas and mining companies would enable civil society, the press, and the public in developing countries to hold their governments accountable.

With the discovery earlier this year of an estimated \$1 trillion in mineral deposits in Afghanistan, transparency in that country has become a matter of U.S. national security. Without proper tracking and reporting on exactly how much mineral is mined and where the money goes, billions of dollars could make their way into the hands of the Taliban and Al-Qaeda associates. These funds could then be used to purchase arms to kill American soldiers and to fund the very international terrorist networks we are working to unravel. Corruption could further diminish the availability of mineral extraction revenues for programs that benefit the Afghan people and deny them the benefits of development under a democratic form of government.

Most Americans do not want to invest their life savings in companies, which have financial ties to governments that threaten international peace and stability or commit atrocities against their own citizens. From California to Massachusetts, the successful Sudan divestment campaigns of the last several years have clearly demonstrated that the American people do not want their money to support civil strife in developing countries. Providing American investors with access to information on which companies have financial ties to regimes with egregious human rights records, such as Sudan and Burma, or regimes with dangerous agendas, such as Iran, is an important investor protection.

The extractive industries transparency requirement will help to strengthen our national security, protect American investors, fight corruption, and free up additional resources in developing countries for some of the world's poorest people. I hope Secretary Geithner will work with me and other concerned Members of Congress to ensure that this provision of the Dodd-Frank Act is fully and effectively implemented.

I also urge the Secretary to leverage this new law to secure the adoption of similar laws in other G-8 and G-20 countries. The adoption of strong transparency laws for extractive industries by all of our G-8 and G-20 allies would improve transparency throughout these worldwide industries.

I look forward to hearing the Secretary's testimony and I yield back the balance of my time.

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**Treasury Secretary Timothy F. Geithner
Written Testimony
House Financial Services Committee
Wednesday, September 22, 2010**

Chairman Frank, Ranking Member Bachus, and members of the Financial Services Committee, thank you for the opportunity to testify before you today about international regulatory issues relevant to the implementation of the Dodd-Frank Act, particularly reform of global capital standards.

Last week the Federal Reserve, the OCC, and the FDIC reached agreement with their principal foreign counterparts to substantially increase the levels of capital that major banks will be required to hold. As a result of this agreement, banks will have to hold substantially more capital. The new standards are designed to ensure that major banks hold enough capital to withstand losses as large as what we saw in the depths of this recession and still have the ability to operate without turning to the taxpayer for extraordinary help.

This agreement will make our financial system more stable and more resilient. By forcing financial institutions to hold more capital, we will both constrain excessive risk-taking and strengthen banks' abilities to absorb losses. This agreement is designed to allow banks to meet these more stringent standards gradually over time, so that they can continue to perform their essential function of providing credit to households and businesses.

These standards will help establish a more level playing field around the world. By moving quickly to recapitalize our financial system, we have been in a strong position to insist on tough standards abroad.

The Importance of Capital and Liquidity

Excess leverage, a term that describes the amount of risk firms take relative to the financial reserves they hold against those risks, has played a central role in virtually all financial crises.

Capital requirements determine the amount of losses firms can absorb and the magnitude of the risks they can take without risking failure. They help the market provide discipline by forcing shareholders who enjoy profits in good times to be exposed to losses in bad times.

Capital requirements are the financial equivalent of having speed limits on our highways, antilock brakes and airbags in our cars, and strong building codes in communities prone to earthquakes.

Failures in our system of capital requirements were major contributors to the severity of this crisis. Where we had capital requirements, they were too low and they were not supplemented with complementary liquidity requirements. Furthermore, there were no systematic capital requirements in the rapidly emerging "shadow banking" system. Finally, capital standards were not applied consistently around the world. Banks in many parts of the world were allowed to operate with low levels of capital relative to the risks they took on.

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At last year's Pittsburgh Summit, the G-20 Leaders, led by the Obama Administration, called for financial institutions to raise the quality and quantity of capital, strengthen liquidity standards and implement rules to limit leverage. Strengthening capital requirements for major financial institutions was also an important objective in the legislative debate on reforming U.S. financial regulation. Both the Dodd-Frank Act and the Basel process are designed to ensure that major financial institutions are subject to rigorous and consistent capital requirements. The agreement just reached in Basel is an important step towards realizing that goal and fulfilling the G-20's call, and it will be presented to G-20 Leaders at their November Summit in Seoul.

The New Standards

The work of the Basel Committee over the last year, culminating in the agreement announced last week, will significantly tighten the system of global capital requirements in a number of important ways.

First, the amount of capital that banks will be required to hold relative to risks they take will increase substantially.

Under the new agreement major banks will be subject to two tiers of capital requirements. All firms will need to hold a substantial minimum level of capital. Further, they will be required to hold an added buffer of capital above the minimum. If a firm suffers losses that force it to eat into that buffer, it will have to take active steps, such as reducing dividends or limiting share repurchases, to restore the buffer. The buffer is important because it will force banks to move more quickly to strengthen their balance sheets as the risk of potential losses increases.

Capital requirements are set relative to a bank's assets, which are weighted to reflect the riskiness of those assets. That is, capital requirements are defined as a ratio of so-called "risk-weighted assets" (RWA). The level of the new minimum and buffer – 4.5 percent and 2.5 percent of banks' RWA, respectively – have been set to ensure that major banks hold enough capital so they can withstand losses similar to what we saw in the depths of this recession and still have the ability to operate without turning to the taxpayer for extraordinary help.

Second, banks will be required to hold more capital against more risky products and activities, including derivatives, which caused substantial financial damage during the crisis. These assets and exposures are held predominantly by the very largest firms. Consequently, this aspect of the Basel reforms will generate large increases in capital requirements for risky activities typically undertaken by the biggest banks, but is likely to have only a modest impact on smaller banks.

Third, the Basel agreements will improve the quality of capital that banks hold. In contrast to the current rules, which allow a wide range of forms of capital, the new requirements are set in terms of high quality common equity, tightly defined to mean capital that will truly absorb first losses when firms get into trouble.

Taken together, the new Basel agreements impose a very substantial increase in capital requirements on banks around the globe. The change in the ratios alone represents more than a three-fold increase in high quality capital required in the system. Before the recent crisis, banks were implicitly required to hold common equity equal to 2 percent of their risk weighted assets. Now banks will effectively be required to hold tangible common equity equal to 7 percent – the

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4.5 percent minimum plus the 2.5 percent buffer – of their risk-weighted assets. In addition, both the new more restrictive definition of what is allowed to count as capital and the more stringent assessment of the risks associated with derivatives, trading-related assets, and exposures to other financial firms will effectively raise capital requirements even further. Importantly, these additional effects will fall most heavily on the largest, most inter-connected banks.

In addition to new capital requirements, the Basel Committee has agreed to impose new global standards for liquidity management. During the recent crisis banks were poorly prepared for the funding pressures that occurred, and this was a major factor that intensified stress throughout the financial system. The new liquidity standards are designed to ensure that firms can withstand a severe shock in liquidity without deepening a crisis by, for example, selling assets in a panic, cutting credit lines indiscriminately, or turning to central banks for excessive liquidity support.

The Basel Committee also agreed that banks should be subject to a U.S.-style cap on leverage as a backstop for the more complex risk-weighted capital requirements. The new internationally applied leverage ratio requirement will, for the first time, include firms' off balance sheet commitments and exposures.

Finally, the recent agreement, by providing a more constrained definition of capital and by expanding to include new international standards on liquidity and aggregate leverage, provides a framework for more rigorous and consistent global capital standards.

We cannot know with certainty how the economy and the financial system will evolve, but these heightened capital requirements, along with other important reforms, should substantially reduce the likelihood that we will soon repeat the sort of severe financial crisis that we have just lived through.

The Transition

Capital requirements are going up substantially. But if we were to raise them too fast we could hurt economic recovery. To limit that possibility, the agreement gives banks a meaningful transition period to meet the new standards.

The new capital requirements will not become effective until the beginning of 2013, and banks will not have to meet the full minimum common equity capital requirement of 4.5 percent of risk-weighted assets until the beginning of 2015. The buffer will be phased in between 2016 and 2019. In addition, the definition of capital becomes progressively more stringent between 2013 and 2018.

It is important to note that because we moved so quickly with the bank stress tests in early 2009 that forced banks to raise more common equity, the U.S. financial system is in a very strong position internationally to adapt to the new global rules. For the most part, banks should be able to meet these new requirements through future earnings, which will help protect the recovery currently underway.

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The Road Ahead

The agreement that has just been reached is a major milestone in the process of reforming global capital standards. But we still have more work to do.

The liquidity requirements are a new part of the Basel system. We will need to make sure that they are calibrated correctly before they are fully implemented.

It is also essential that the Basel agreements are implemented by national authorities in a way that generates a 'level playing field' in our increasingly integrated global financial system. We will engage our foreign counterparts to look for ways to ensure that these agreements are implemented in a transparent and consistent way by supervisors in different countries.

We will also continue to explore innovative ways, such as the use of counter-cyclical buffers and contingent capital, to expand the capacity for the system to absorb unexpected losses without amplifying shocks to the system.

The new capital standards have to be implemented at the national level. The agreement that was just reached, and other so-called Basel III proposals, must be fully implemented through national regulations by the end of 2012. The United States is committed to meeting these deadlines.

In conclusion, the agreement reached in Basel last week, working with the Dodd-Frank Act, will significantly lower the probability and severity of future financial crises, and it will help protect taxpayers by limiting excessive risk-taking by financial institutions. The Basel agreement is the result of thoughtful and diligent work by the men and women of key regulatory and supervisory agencies here and around the world. We owe them our thanks.

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Questions for the Record

U.S. House of Representatives

House Financial Services Committee

**Hearing on “The State of the International Financial System, Including
International Regulatory
Issues Relevant to the Implementation of the Dodd-Frank Act”**

Treasury Secretary Timothy F. Geithner

September 22, 2010

Questions from Representative Paul E. Kanjorski

1. **Secretary Geithner, in regard to the Alternative Investment Fund Managers Directive (AIFMD), currently under consideration by the European Union, in March of this year you wrote to the EU to express your concerns that various drafts of this proposed regulation would “discriminate against US firms and deny them access to the EU market that they currently have.”**
- **Given press reports that suggest the EU is still contemplating various protectionist elements to that regulation, such as requiring funds be physically located in an EU country, are you still concerned it will discriminate against US-based firms?**

The AIFMD text agreed to by European Member States on October 19 and expected to be voted on by the EU Parliament on November 11 would not include a physical location requirement (head office) for offshore fund managers. The EU would instead require offshore fund managers to appoint a legal representative in the EU Member State where it is registered. However, the requirement may still be onerous if the EU interpretation of the Directive assigns legal responsibility for the firm’s compliance to the legal representative. For instance, in the U.S., a firm’s representative to the SEC is an agent for service of process and is not legally responsible for the firm’s compliance. We will monitor closely the implementation of the Directive once it is approved.

While we welcome the important step made by the European Member States and the European Parliament in negotiations on the Alternative Investment Fund Management Directive, we would prefer that the EU not delay the introduction of a passport non-EU AIFM for two years after the passport is granted to EU managers. We are also concerned by the possibility that the commencement of the passport regime could be blocked by a negative recommendation of the future pan-European regulator (ESMA), or could be blocked by a Qualified Majority Vote in the European Council or by an absolute majority vote in the European Parliament.

2. **The AIFMD requires that each fund have a “single depositary” that would, among other things, be responsible for the safe custody of assets of a European investor for a non-EU fund alternative investment vehicle. This requirement would, effectively, concentrate vast sums of investor capital in a handful of firms given the limited amount of European financial institutions that would meet the definition of a depositary.**
 - **Would a feature like this, even one which could allow for sub-custodial relationships, be contrary efforts to mitigate systemic risk (one of the stated G20 objectives) because of concentration of too much capital into a handful of European banks?**

The AIFMD text agreed to by EU Finance Ministers on October 19 and expected to be voted on by the EU Parliament on November 11 does not limit non-EU funds to an EU depositary. The language stipulates that depositaries can also be located in the home country of the non-EU fund, as long as the depositary is subject to effective prudential oversight to the same effect as in Europe, and the home country's laws are being effectively enforced as determined by the European Commission. Although the most current text regarding depositaries attempts to ameliorate the concentration of systemic risk in Europe, we will be carefully monitoring implementation of the European Commission's standards for equivalence.

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September 6, 2010

One Nation, Two Deficits

By PETER ORSZAG

The nation faces a nasty dual deficit problem: a painful jobs deficit in the near term and an unsustainable budget deficit over the medium and long term. This month, the Senate will be debating an issue with significant implications for both — what to do about the Bush-era tax cuts scheduled to expire at the end of the year.

In the face of the dueling deficits, the best approach is a compromise: extend the tax cuts for two years and then end them altogether. Ideally only the middle-class tax cuts would be continued for now. Getting a deal in Congress, though, may require keeping the high-income tax cuts, too. And that would still be worth it.

Why does this combination make sense? The answer is that over the medium term, the tax cuts are simply not affordable. Yet no one wants to make an already stagnating jobs market worse over the next year or two, which is exactly what would happen if the cuts expire as planned.

Higher taxes now would crimp consumer spending, further depressing the already inadequate demand for what firms are capable of producing at full tilt. And since financial markets don't seem at the moment to view the budget deficit as a problem — take a look at the remarkably low 10-year Treasury bond yield — there is little reason not to extend the tax cuts temporarily.

A benign bond market, however, is a luxury we won't enjoy forever if we fail to tackle our long-term fiscal problem. What's more, losing the confidence of the bond market could prove painful, since it is widely known that our fiscal trajectory is unsustainable and market sentiment may therefore shift quickly and unpredictably. In any case, as the economy recovers, the dominant problem will move from depressed demand to excessive budget deficits.

Despite a dire fiscal outlook, many progressives want to make the tax cuts permanent for all but the very highest earners. Many conservatives are even worse: they'd make the tax cuts permanent for the likes of Warren Buffett, even though he'd prefer they didn't. Making all the tax cuts permanent would expand the deficit by more than \$3 trillion over the next decade.

Both approaches lock us into a budget scenario out of which there are few politically plausible routes of escape. Although hardly anyone wants to admit it, we're not going to solve our budget problem over the next decade unless revenue is part of the equation.

Let's look at the facts. The projected deficit for 2015 is 4 percent to 5 percent of G.D.P., depending on whose assumptions you use. A sustainable level is more like 3 percent or lower. So we need deficit reduction of 1 percent to 2 percent of G.D.P., or about \$200 billion to \$400 billion a year by 2015. These figures are uncertain, but they're the best we have (and they may well turn out to be too optimistic).

How much savings is plausible on the spending side? Medicare, Medicaid and Social Security will account for almost half of spending by 2015. Even if we reform Social Security, which we should, any plausible plan would phase in benefit changes to avoid harming current beneficiaries — and so would generate little savings over the next five years. The health reform act included substantial savings in Medicare and Medicaid, so there aren't further big reductions available there in our time frame.

The other half of the budget is mostly net interest (which is not negotiable unless we renege on our debt) and discretionary spending. Discretionary spending is split roughly equally between defense and non-defense spending. The defense component already assumes a phase-down in both Iraq and Afghanistan; saving an additional 5 percent of the Pentagon's base budget would be a substantial accomplishment and would yield about 0.2 percent of G.D.P. Cutting 5 percent out of non-defense discretionary spending, a stretch politically, would save about as much.

It would be tough, then, to squeeze more than a half percent of G.D.P. from spending by 2015. Additional revenue — in the range of 0.5 to 1.5 percent of the economy — will therefore be necessary to reduce the deficit to sustainable levels.

How would we do this?

One possibility would be to establish a new source of revenue, perhaps through revenue-increasing tax reform, and possibly including a modest value-added tax (that is, a V.A.T. of 5 percent to 6 percent). This approach has many potential benefits, including the opportunity to improve our tax code by cutting back on loopholes and shifting toward a consumption-based tax system. It is also politically impossible, at least in the era of the 60-vote Senate. Those who fear a V.A.T. have little reason to worry — the votes aren't there.

The beauty of extending the tax cuts for only two years is that canceling them doesn't require an affirmative vote. It happens by default, so Congressional deadlock works in its favor. And it would essentially solve our medium-term deficit problem, reducing the deficit by \$200 billion to \$350 billion a year from 2015 to 2020.

Like all plans, this one isn't perfect. Some may complain that higher marginal tax rates, even if deferred

until 2013, will cripple small businesses and economic activity. It's hard to believe, however, that effectively returning the tax code to its 1990s form would lead to economic catastrophe, especially when many leading Republican economists -- including Alan Greenspan and Martin Feldstein -- agree that we can't afford to continue the tax cuts forever. More troubling, middle-class and lower-class families would be saddled with higher taxes. That's a legitimate concern, but also a largely unavoidable one if we are to tackle the medium-term fiscal problem.

Finally, a key part of this deal is actually ending the tax cuts in 2013 -- and that will surely require a presidential veto on any bills to extend them after that. (Failing to follow through would be particularly problematic if the high-income tax cuts are made permanent -- at a 10-year cost of more than \$700 billion.) Minimizing this risk requires as much upfront clarity and commitment as possible, including a strong and unambiguous veto threat from the president.

Senate Democrats and Republicans almost never come together anymore. This month, they should fight the dual deficits rather than each other. Let's continue the tax cuts for two years but end them for good in 2013.

Peter Orszag, the director of the White House Office of Management and Budget from 2009 to 2010 and a distinguished visiting fellow at the Council on Foreign Relations, is a contributing columnist for The Times. He will also be writing at nytimes.com/opinionator.

