SEN. MAX BAUCUS HOLDS A HEARING ON THE NOMINATION OF TIMOTHY GEITHNER TO BE TREASURY SECRETARY - COMMITTEE HEARING

37,683 words
21 January 2009
Political Transcripts by CQ Transcriptions
English
(C) 2009 CQ Transcriptions, Inc. All Rights Reserved.

(CORRECTED COPY: CORRECTS WITNESS LIST)

SENATE COMMITTEE ON FINANCE HOLDS A HEARING ON THE NOMINATION OF TIMOTHY GEITHNER TO BE TREASURY SECRETARY

JANUARY 21, 2009

SPEAKERS: SEN. MAX BAUCUS, D-MONT. CHAIRMAN SEN. JOHN D. ROCKEFELLER IV, D-W. VA. SEN. KENT CONRAD, D-N.D. SEN. JEFF BINGAMAN, D-N.M. SEN. JOHN KERRY, D-MASS. SEN. BLANCHE LINCOLN, D-ARK. SEN. RON WYDEN, D-ORE. SEN. CHARLES E. SCHUMER, D-N.Y. SEN. DEBBIE STABENOW, D-MICH. SEN. MARIA CANTWELL, D-WASH.

SEN. CHARLES E. GRASSLEY, R-IOWA RANKING MEMBER SEN. ORRIN G. HATCH, R-UTAH SEN. OLYMPIA J. SNOWE. R-MAINE SEN. JON KYL, R-ARIZ. SEN. JIM BUNNING, R-KY. SEN. MICHAEL D. CRAPO, R-IDAHO SEN. PAT ROBERTS, R-KAN. SEN. JOHN ENSIGN, R-NEV.

WITNESSES: PAUL VOLCKER, FORMER CHAIRMAN, FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS

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

[*] BAUCUS: The committee will come to order.

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

The nominee before us today has pretty much been nominated to restore confidence in the U.S. economy. It won't be easy. To restore this confidence we must restore faith in the honesty and transparency of financial institutions.

We must honor the obligations to which we have committed ourselves, and we must protect the principles on which our economic system is based.

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

This trust must be earned. And once earned, this trust must be maintained.

Close scrutiny of Mr. Geithner’s tax returns uncovered several errors, and the questions have arisen regarding his employment of household help. I expect him to answer questions regarding these issues honestly and completely.

These are disappointing mistakes, but after discussing them with Mr. Geithner, I believe them to be innocent mistakes. I believe that Mr. Geithner has sufficiently corrected the errors. I know a man of Mr. Geithner’s talent and dedication will be meticulous on these points in the future.

More broadly, I also suspect Mr. Geithner to give the American people and Congress the respect that they
deserve.

The secretary of the treasury cannot ask Congress to make middle of the night decisions that cost taxpayers hundreds of billions of dollars. The secretary cannot refuse to explain why immediate massive action must be taken without time for consultation or discussion.

The secretary cannot ask Congress to commit massive funds on the basis of a three-page proposal.

If ever there was a time for those kinds of actions, that time has passed. Rather, we must have faith that the secretary's actions and those of the Treasury Department will be open, and it will be transparent.

We must know that the secretary will help enforce the laws passed by Congress. The secretary must protect the fundamentals of our economy, and the secretary must unselfishly give up himself to successfully complete the task at hand.

The global economic crisis requires unprecedented action. The Troubled Asset Relief Program, the TARP, authorized $700 billion to stem the financial crisis.

When Congress authorized this money, we promised the American people that the U.S. government would be good stewards of their hard-earned tax dollars. The secretary must ensure that these dollars were not spent in pain.

We also promise that we would keep the TARP program honest. I fought for a special inspector general to oversee the program that was enacted. The secretary must ensure that the special IG has access to all of the information and resources that he needs to get the job done.

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

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

BAUCUS: I urge Mr. Geithner to find ways to help small businesses. In Montana, all businesses are small businesses. They are struggling. They are feeling the brunt of both the credit freeze and the economic slump.

Small businesses are the engine of local economies. Collectively, they are too big to fail. We must ensure that TARP does not ignore them.

In addition to administering TARP, Mr. Geithner will be responsible for overseeing the Internal Revenue Service. The IRS employs nearly 100,000 people. It is responsible for collecting the tax revenues that fund our government.

We owe it to all Americans to ensure that all taxpayers file their returns honestly and in a timely fashion. Especially now, the IRS must collect all revenues it is owed, and we must pursue those who evade their taxes by improperly moving their assets offshore.

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

I think for most of China. Secretary Paulson established the United States China Strategic Economic Dialogue, otherwise known as the SED. Continuing a good, strong, vigorous, constructive dialogue similar to the SED I think is critical. And we can waste no time doing it.

Assuming such a dialogue is not just talk. It's about reforming our relationship to unwind unsustainable balances. It's about getting our relationship on a firm footing. And it's about finding the balance that is sustainable and mutually prosperous.

We also need to reform our relationship with Cuba. The secretary oversees the Office of Foreign Asset Control, otherwise known as OFAC. OFAC has allocated way too much precious time and money and effort to enforcing our trade embargo with Cuba.

This makes it difficult for Montana farmers and farmers in other states to sell their products in a market 90
miles from the United States. This also squanders resources that OFAC could use to fight terrorism -- terrorism financing around the globe. The secretary's responsibilities are formidable. I have confidence that Mr. Geithner is up to the job. I have confidence that he will address the important obligations that he will inherit with honesty and honor. And I have confidence that, with the help of his unselfish performance, America will overcome these troubled times and emerge with renewed strength.

Senator Grassley?

GRASSLEY: Congratulations to the nominee -- not so much congratulations to the office he's been selected to go to, but because I know it has a great deal of personal sacrifice and financial sacrifice.

Thank you, Mr. Chairman, for the hearing.

Today we perform one of the most important functions of this committee. We examine the qualifications of the man nominated to be the next treasury secretary.

I come into this hearing with a profound sense of concern and worry about the future of our financial system. Yesterday I was heartened to hear President Obama say, quote, "What is required of us now is a new era of responsibility."

For President -- that's the end of the quote -- for President Obama, that era of responsibility will begin with his Cabinet, and I look forward to helping facilitate that.

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

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

Plus the legislation was important to many taxpayers and to Iowans specifically because that was added to the TARP bill. However, last Thursday I voted against allowing the secretary of treasury to access to access the second half of the 700 billion in bailout funding.

Instead of using the first payment of 350 billion to purchase troubled assets as the name Troubled Asset Relief Program suggested, and how it was sold to us, the money has been erratically and arbitrarily distributed in a monstrous act of government intervention and ownership over our financial markets.

In addition to the TARP program, taxpayer's dollars are on the line in bailouts of Bear Stearns and AIG. The Federal Reserve has loaned money to three special purpose vehicles, which are all limited liability companies that use federal funds to purchase -- I should say fed funds -- to purchase troubled assets.

Maiden Lane I, accepted residential and commercial owns, as well as derivatives, including credit default swaps from Bear Stearns in connection with its purchase of JP Morgan. In similar deals related to AIG rescue Maiden Lane II hold residential mortgage backed securities, while Maiden Lane III holds a collateral date obligation purchased from the credit default swap counterparties.

It would seem that the fed's investment in these SPVs is based on the valuation of assets, which was conducted in all three cases by Black Rock Financial, who also I understand, now manages these assets.

I championed the need for Special Inspector General at TARP and supported the various Congressional oversight duties including the mandate for GAO reports on the program, which at least shed some on light on the activities and transactions under the TARP. Similar transparencies and oversight of the bailout conducted outside of the TARP is also needed.

In addition to these concerns about how the TARP and other bail -- bailouts have been managed to date, we have to consider what we have learned about the nominee's tax history. The nominee's troubled tax history was made public last -- last week in a bipartisan finance document. And I think I'm in -- accurate in saying that we have done it the same way that Senator Baucus and I have been leaders of this committee to make that information public, if the nominee decided to go forward. I ask unanimous consent that the committee staff memorandum released to the members on Tuesday, January the 13th, along with supporting documentation being printed in our hearing record.

BAUCUS: No objection.
GRASSLEY: Since the report was issued, additional questions have arisen specifically about the nominee’s failure to pay self employment tax on his IMF income reported on his tax returns for the years 2001 through 2004. And the press has documented many of those questions.

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

BAUCUS: No objection.

GRASSLEY: Over the past few years this committee has spent a lot of time examining the tax gap. The tax gap is the difference between what taxpayers legally owe and what they actually pay. The nominee has been found to be a tax gap participant. In addition to failing to pay self employment taxes while working for the International Monetary Fund, the nominee’s returns contained other irregularities that ended up to his owing $48,268.00 in taxes and interest in the IRS.

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

A troubling fact has emerged, the IRS audit of 2006 yielded a demand by the IRS that nominee pay self employment taxes for the years 2003 and 2004. The nominee paid the taxes due for those years. During the audit, it became clear that the same liability existed for the nominee’s 2001 and 2002 returns. The IRS, however, was barred by statute of limitations from collecting for those years. Shortly after President Elect Obama expressed an intent to nominate him, on the advice of the transition team, the nominee amended his 2001 and 2002 returns and paid the amount owed. Furthermore, the nominee received tax allowances from the IMF -- the IMF to pay the difference between the self employed and employed obligations of Social Security tax.

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

His involvement and implementing the TARP gives him unique insight into how we have gotten to where we are today. To some he isn’t merely the best choice, to some he is the only choice. On the other hand, we need to consider how much the nominee’s tax history could reflect on a Secretary of Treasury. As secretary the nominee would be in charge of the IRS. If confirmed would the nominee be effectively leading his department. How much does his troubled tax history reflect on his judgment as a decision maker? These are some of the issues that this committee must consider.

So I propose to the nominee, are you the general growing on your financial sector expertise, who will marshal the financial troops and assets of the Treasury Department to lead our nation to prosperity? Or are you the general with this troubling tax episode of the past who will lead the nation’s tax policy and administration system? These are two key questions that we face today.

I look forward to the testimony.

Thank you Mr. Chairman.

BAUCUS: Thank you very much, Senator. And now as our witness is from the Empire State, notice that one of the members of our committee also from the Empire State is here, I recognize him to introduce him to the committee.

SCHUMER: Thank you, Mr. Chairman.

First, thank you for you outstanding leadership of this commitment.

And I want to thank Senator Grassley, I know he is very sincere about the difficulties he is weighing.

It’s my privilege to be here today to introduce Timothy Geithner as President Obama’s nominee to be treasury secretary. Mr. Chairman, in these times as our financial system is sailing into uncharted and turbulent waters there is no navigator more suited for this job by way of intelligence, experience, inclination, and temperament than Tim Geithner.

Tim has made some mistakes, which he has freely admitted and corrected. But these errors pale before the myriad mistakes made by the operators of financial institutions and government regulators overseeing them. We need the very best, not the second best person in treasury to correct those mistakes.
Tim's career in government began 20 years ago as a staffer at Treasury. His abilities quickly launched him up the career ladder and by the mid-1990s he was Senior Crisis Manager with then Secretary Rubin and then Deputy Secretary Summers and helped guide the U.S., and indeed the global financial system, in -- through a series of international financial crises, including the Asian financial crisis in 1997 and 1998.

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

Far before many other regulators, Tim had recognized the extent of the danger that our economy faced and was trying to raise awareness. In the aftermath of the Bear Stearns failure Tim noted the current crisis was so severe that it was, "not something that market can solve on its own."

And in July he called on Congress to establish a legal framework for dealing with the failures of non-bank financial institutions. Had we heeded his advice then, the Treasury Department and the Federal Reserve might not have faced the failure of Lehman Brothers with an empty regulatory toolbox.

Tim has also been a leader on financial regulatory reform. In September of 2006 he led other regulators in calling for enhanced regulation of hedge funds. In April of 2008, Tim called for a major overhaul of this system, not just in structure but also in the way regulators do their jobs and the policies that we implement to ensure stability.

He noted that, "Our objective should be a system that preserves the unique strengths of our financial markets in providing individuals and entrepreneurs access to capital and credit, but with a greater capacity to withstand stress."

However, as takes on this monumental position there are few things he must keep in mind. First, he must lead the Treasury Department in a full reexamination of the TARP program, as you stated Mr. Chairman, and the other governmental responses to the crisis to ensure that they are achieving their goals of stability, promoting lending, and protecting taxpayers.

The previous TARP program gave the banks too much dessert before it made them eat any of their vegetables. Secretary Geithner must be the responsible parent and restore some balance to this situation. I have confidence he will.

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

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

The fact of the matter is that for far too long this country has relied on easy credit to support its growth. We need to redevelop stable long term industries that can survive the ups and downs of the business cycle. We need to reinvigorate American manufacturing, stimulate American savings, and end our national addiction to debt.

We cannot be a country that imports more than we exports, borrows more than we save, consumes more than we produce. It will not be easy. But I'm confident that if we commit ourselves to this task under Tim's hand on the tiller American will emerge as the strongest nation on the planet for the next 50 to 100 years.

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

I'd like to close by thanking him for his willingness to continue serving his country in troubled times. God knows that he's paid his dues and then some over the past 18 months, not to mention the past 20 years.

And while he could easily go to the private sector and work less hours for many than he'll make as government employee, he's chosen to accept the challenge the President Obama presented to all of us and to continue to devote himself to serving his country and striving to make the world economy a better and safer place. For that, I commend him.

Thank you, Mr. Chairman.
BAUCUS: Thank you Senator. Thank you for that introduction. I'd now like call on the Honorable Paul Volcker, former Chairman of the Federal Reserve Board for an introduction.

VOLCKER: (OFF-MIKE)

BAUCUS: Mr. Chairman, you might want to pull your microphone a little closer to you, perhaps turn it on first.

VOLCKER: That might help.

BAUCUS: That might help, thank you.

VOLCKER: It's even more of privilege no you can hear me to appear before the committee.

BAUCUS: Indeed.

VOLCKER: And to support Tim Geithner's appointment as Secretary of the Treasury.

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

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

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

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

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

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

He occasionally reminds me that our paths briefly crossed some 25 years ago when I addressed his graduating class at Dartmouth. Now I can't claim that I provided any impetus or inspiration for his career. In fact, my memory is that the public address system closed down shortly after I began my address. But what has become amply clear in the ensuing 25 years is Tim Geithner's commitment to public service. His career path up through the ranks of the Treasury is a model. It's a model I'd like to see inspire and be emulated by others attracted to public service. And I think it's also true that he is exceptionally well placed to enhance the professional strength of the Treasury which should be a matter of some concern to this committee.

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

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

Now I can't reasonably claim that any one person is absolutely indispensable, but as you address this nomination -- as you address his nomination, consider that Mr. Geithner brings unique qualifications in terms of hands-on experience, recognition in financial markets, and the confidence in which he is held by the new
president of the United States.

You have a constitutional duty to confirm his nomination and to exercise that duty with great care. I do hope that that process can be completed with some dispatch so that President Obama can have his full team in place to deal with the pressing financial crisis that simply will not wait.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Mr. Chairman.

I now turn to witness Mr. Geithner.

Mr. Geithner, your prepared statement will be automatically included in the record. I ask you to proceed for about five minutes or so. Before you proceed, is anyone here in your family that you'd like to introduce?

GEITHNER: Thank you, Mr. Chairman. Thank you, Mr. Chairman.

I'd like to introduce my -- my wife, Carole, staying -- sitting behind me, and my father, Peter Geithner, on my left.

BAUCUS: Well, could you both stand, please?

Thank you very much for your participation and being a part of this team, too. Thank you very much for your participation.

OK. Mr. Geithner, you can proceed.

GEITHNER: Chairman Baucus, Ranking Member Grassley, and members of the committee, it is a great honor for me to stand before -- to sit before you today.

I want to thank you for meeting with me over these last few weeks and for giving me a chance to hear your interests and your concerns.

I am deeply grateful to the president for asking me to lead the Treasury Department of the United States at this critical moment in our nation's history.

And I am particularly grateful to my wife, to my family for all their support and for their sacrifice.

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

Throughout my career, I have had the great privilege of serving our country in institutions responsible for U.S. economic policy. In these roles, I have learned some very important lessons about government and about economic policy.

I believe that confidence in the strength and integrity of our financial system, confidence in our commitment to fiscal prudence, and confidence in the value of our currency are absolutely critical to the fortunes of all Americans. I believe that markets are central to innovation and to growth, but that markets alone cannot solve all problems. Well-designed, strongly enforced financial regulations are absolutely essential to protecting the integrity of our economy.

I also believe that as America's economic fortunes become ever more closely tied to those of the rest of the world that we need to invest more at home in helping Americans deal with the challenges of trade and technological change. And finally, I believe that our national security depends critically on our economic strength. We can have a great and positive impact on the global economy, but only if the quality of our ideas and our actions win the support of other nations.

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

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

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

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

Now the American Recovery and Reinvestment Plan that is now before the Congress will meet that test. It provides powerful and direct support to help get people back to work; to encourage private investment; to break the cycle currently crippling our economy, a cycle in which concern about growth hurts investment and spending, causes further job losses, and makes it harder for families and businesses to get access to credit. This plan, the American Recovery and Reinvestment Plan, is a critical part of the solution, but it has to be accompanied by aggressive action to address the housing crisis and to get credit flowing again.

Last fall, Congress passed the Emergency Economic Stabilization Act. Your action -- and I know this was a difficult decision for many of you at the time. Your action helped prevent financial catastrophe, and the actions of the Senate last week to authorize additional resources will enable us to take additional steps to reinforce recovery.

President Obama and I believe that this program needs reform. I know there are serious concerns about transparency and accountability, about -- confusion about the goals of the program, and a deep skepticism about whether we are using the taxpayers' money wisely.

We have to reshape and redesign this program to ensure there is credit available to support recovery. We will do this with conditions to protect the taxpayer and the necessary transparency to allow the American people to see how and where their money is being spent. This program -- this financial program -- is absolutely essential to recovery, and we need to make it work.

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

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

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

Senators, in this crisis, our financial system failed to meet its most basic obligations. The system was too fragile and unstable, and because of this, the system was unfair and unjust. Individuals, families, and businesses that were careful and responsible were damaged by the actions of those who were not. So we need to move quickly to build a stronger, more resilient system with much greater protections for consumers and for investors, with much stronger tools to prevent and respond to future crises.

We've experienced a great loss of faith in our economy, but we have not lost the most fundamental of American abilities: the ability to adapt, to change, and to reform. This will take time, it will require action on a scale that we have not seen in generations, and we will have to keep at it until we restore the confidence of Americans and of the world in America's economic leadership.

This is my commitment to you, and this is President Obama's promise to the American people. We are a strong nation with great resources. We can meet these challenges. Our shared goal is a healthy, more stable, and more competitive-free-market economic system that can once again do what it does best: to encourage people to invest and invent, to innovate and create jobs, and to build stronger communities and better lives.
I want to say how grateful I am to my colleagues at the New York Fed and at the Federal Reserve System. Like the career staff of the Treasury, they are an exceptionally talented and dedicated group of public servants. They are brave, creative, and pragmatic, and it has been my great privilege to work with them. Senators, before I finish, I want to address directly the concerns many of you have raised about the mistakes I made in preparing my tax returns. These were careless mistakes. They were avoidable mistakes, but they were unintentional. I should have been more careful. I take full responsibility for them. I have gone back and corrected these errors and paid what I owed. I want to apologize to the committee for putting you in the position of having to spend so much time on these issues when there is so much pressing business before the country.

If you and your colleagues give me the opportunity to serve as secretary of the treasury, then I will do everything I can to justify your trust and your confidence.

GEITHNER: Thank you.

BAUCUS: Thank you.

Mr. Geithner, before I ask my questions, our committee has the tradition of asking three standard questions of all nominees. Here they are.

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

GEITHNER: No.

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

GEITHNER: I do not.

BAUCUS: Do you agree without reservation to respond to any reasonable summons to appear and testify before any duly constituted committee of the Congress, if you're confirmed?

GEITHNER: Absolutely.

BAUCUS: Thank you.

The basic question I think that most Americans have today -- I mentioned it earlier -- is the lack of confidence in today's financial system. It's been there quite a -- quite a while, unfortunately.

You've alluded to some actions that might be taken to restore that confidence in your prepared statement. Would you just today -- today now directly tell the American people what you're going to do to help restore that confidence as quickly as it possibly can be achieved? What are you going to do?

GEITHNER: Senator, you're absolutely right that we've seen a just catastrophic loss of trust and confidence, and trust and confidence...

BAUCUS: You might pull the microphone a little closer to you.

GEITHNER: Thank you.

And when you lose trust and confidence, it's very hard to reach store it, and it takes a lot of care and attention to bring it back.

And what the president's going to do if he's going to come before the Congress, we hope in the next few weeks, and lay out to the American people a comprehensive plan to help stabilize the core of our financial system so that the -- the banks that are so critical to our economy are able to provide the credit necessary to get recovery going again.

He's going to lay out a comprehensive plan for addressing the housing crisis in this country, which has been so central to the recession and its basic causes.

And he's going to lay out a broad set of programs for trying to directly address the constraints that are now making it harder for small businesses, for students, for people who want to buy a car, for municipalities across the country, and to get access to credit to make those things.
And those three things are going to be the central of our -- central part of the president's program.

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

We're going to have to move -- we're going to have to work much more closely together, Senator, with the Treasury and the FED and the FDIC working together rather than separately.

Were going to have -- as you said in your opening statement, work much more closely with other countries and with the international financial institutions, because this is a global crisis. It's going to require a global response.

And our actions here will be more effective if they are taken in close coordination with the actions of the other major financial centers.

And we're going to have to work much more closely with the Congress. I think the world needs to see Congress and the executive branch working together to solve this problem.

We can't be in a position -- we can't -- we will not be effective in restoring confidence unless we see a clear commitment by the country as a whole to work -- to -- to take the actions necessary to solve these problems.

And we will consult carefully with you and work as hard as we can to address the concerns raised by your -- by you and your colleagues.

BAUCUS: And those changes -- or clearly those commissions include very significant limits on executive compensation, on reports and transparency, methods that track how the dollars are being spent, and also addressing conflict of interest potential.

GEITHNER: Absolutely, Senator. The -- the -- Larry Summers, who's the president's designee to run the National Economic Council, provided the Senate -- the Congress -- with two letters last week that laid out a set of detailed conditions and reforms to the program.

We're going to look very carefully at the recommendations by the congressional oversight body, by the GAO and everybody else who's looked at this basic program, and we will -- we will adopt those conditions that we believe will help make the program more effective.

BAUCUS: Now, you alluded to the tax issues. I'd like to give you a chance to go into a little more detail in explaining that one.

GEITHNER: Thank you, Senator, for giving me a chance to do that.

Let me just try to explain a little bit why I believe, looking back now, I got myself in this position.

In 2001 I left the Treasury Department. I went to work for the Council on Foreign Relations temporarily, and then ultimately went to the IMF that year.

That year I had several sources of income. Three employers reported income to me and to the IRS on the form W-2 as an employee. I also received self-employment income that year, reported to me on several 1099 forms.

I paid self-employment taxes on the income reported to me as self-employment income. I paid income taxes -- taxes on my W-2 income -- as I always had done so. And I believed mistakenly that I was supposed to file as an IMF employee as I would normally file taxes as an employee generally.

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

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

Now, if I had thought about it more carefully at the time and I'd asked more questions, I would've gone back and asked a bunch more questions about that, and I would've approached it differently.

But as I said in my opening statement, these were -- these were careless mistake. They were avoidable mistakes, but they were completely unintentional. And I take full responsibility for them. And again, I apologize for putting you in the position where you had -- had spent so much time looking through these questions, particularly now.

BAUCUS: Thank you.

Senator Grassley?

GRASSLEY: Mr. Chairman, if I could, I'd like to get Senator Kyl 10 seconds for something he wanted to go back to.

KYL: Mr. Chairman, I simply want to note that -- and I know we all have conflicts -- but I've got some really unavoidable conflict over the next hour and a half or so.

I -- I won't ask for any special consideration, but I do want whatever rounds of time we have available for questioning and to submit any written questions at the conclusion of that that I still have. Thank you very much. I appreciate it.

BAUCUS: Any time, yes.

GRASSLEY: The treasury secretary is responsible for overseeing the IRS, which is tasked with enforcing the tax laws.

In a 2007 report, the GAO indicated that as the 2007 the total unpaid tax debt was $290 billion. This is just the amount that the IRS knows taxpayers owe. This doesn't include the amount due from taxpayers, who do not properly report income. Social Security and Medicare taxes are a key component of the tax gap.

The person ultimately responsible for tax policy must be credible on the issues of tax reform and compliance.

I was a champion of the IRS Restructuring Act of 1998. This legislation imposes significant penalties on IRS employees who do not pay their taxes, including the possibility of being fired.

Not discussing your tax returns, Mr. Geithner, would be like sleeping them under the rug, an option that the IRS employees and the average taxpayer do not have available to them.

Given that the staff and media reports raise significant questions about your late payment of self-employment taxes, I think it's important to set the record straight before we proceed.

As a result, I appreciate responses to the following questions. These questions I hope elicit short answers, since you've been very clear in your opening statement in answer to Senator Baucus.

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

GEITHNER: Yes.

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

GEITHNER: I did.

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

GEITHNER: I did. Yes.
GRASSLEY: OK.

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

GEITHNER: The -- yes.

GRASSLEY: OK.

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

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

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

GEITHNER: I didn't.

GRASSLEY: You -- you did not.

GEITHNER: I did.

GRASSLEY: Oh, you did. OK.

Which brand did you use?

GEITHNER: I -- I'll answer that question, sir, but I want to -- these are my responsibility, not the -- not the tax software responsibility.

GRASSLEY: OK.

GEITHNER: But I used TurboTax to prepare -- to prepare my returns.

(LAUGHTER)

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

GEITHNER: Not to my recollection, Senator. GRASSLEY: If yes -- well, not to your recollection.

Well, I thank you for answering those questions. While I understand that the tax code is complex, and sometimes even tax preparers get it wrong, it would seem that minor due diligence on your part may have prevented the oversight in failing to pay your self-employment taxes.

I appreciate that you've prepared your own returns -- 2001 and 2002. I believe that the tax code should be simple enough so that individuals can meet their responsibilities under the tax code without having to pay expensive lawyers and accountants.

However, I believe that the average Americans are aware of their obligations to pay Social Security taxes, despite the fact that in many cases it may be their employer who remits their taxes on their behalf.

It is deeply problematic if a U.S. citizen with your financial knowledge and expertise doesn't consider whether he should be making a contribution to the Social Security trust fund, when his employer makes clear that it is the employee's responsibility.

You can't blame the tax code for such tax return errors, and you also can't point a finger at tax return preparers -- in this case the IMF, who does well to ensure that people know the law.

Individuals have a responsibility to understand their taxes and ultimately account for them.

Mr. Geithner, over the last five years, Chairman Baucus and Conrad have been aggressive on efforts to close the tax gap. I try to help them in that effort. We've made little -- we've made some progress over that time, but the problem is still huge.
We have Commissioners Everson and Shulman -- have put dent in the tax gap. Treasury brought forward
tax gap proposals. We've enacted a couple of significant ones. One dealt with credit reporting, the other with
stock basis reporting.

Congress passed a pilot project on private debt collections and a three percent withholding proposal for
government contracts.

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

GEITHNER: Senator, the president is committed to working with the Congress on an effective program to
close the tax gap. I share that commitment, and if confirmed by the Senate, I will work very hard to try to
bring forward to the Congress and to continue the progress that you helped lead initiate to try to close that
gap.

There's a bunch of ideas I've heard from you and your colleagues that will help us to do that, and if
confirmed, I will listen very carefully to any -- any sensible idea, work very closely with the commissioner of
the IRS in -- in working in trying to achieve that basic objective.

But the president is committed to that, and of course, I share that commitment.

GRASSLEY: All right. Are there any other proposals that we've already put forth that -- the two that I
mentioned, for instance? There may be more, but private debt collections and a three percent withholding
proposal on government contracts.

Those are a couple that are out there -- our attempt to close the gap.

GEITHNER: Senator, my sense is is that better reporting by third parties and more comprehensive
withholding would be absolutely critical.

The two proposals you raised I'd like to spend a little more time thinking through and talking to you about
them. I've heard concerns on both sides of those issues. But if confirmed, I will come listen carefully to your
concerns and figure out how that to meet those concerns.

GRASSLEY: If you could give me an answer in writing on those two issues, I'd appreciate it -- before your
confirmation.

GEITHNER: Absolutely.

GRASSLEY: OK.

BAUCUS: Thank you, Senator.

Senator Bingaman is next.

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

That may go on to two -- two issues I wanted to ask you about. As -- as Chairman Volker just said here in
testimony to us, the financial system is broken. The question is how do we restore the -- the full credit in our
economy.

BINGAMAN: It seems that there are sort of two -- two ways that that -- this has been attempted. One is the
backstopping of financial institutions. In one way or another, what was done with Citibank, what was done
with Bank of America recently. There's been talk of having a bad bank. And I know the idea there is to
acquire these so- called troubled assets and thereby get them off the books of these companies.

And I guess the Brits have come up with their proposal, as The Financial Times characterized it, to write a
huge insurance contract for the banking sector. Could you just give us a brief comment as to the validity of
some of these proposals, or the -- the different ways that we might approach this? It seems like the whole
thing has been pretty ad hoc up until now.
GEITHNER: Senator, I -- I agree with that concern. And I should emphasize, we're at the beginning of this process of repairing the system, not close to the end of that process. And it is going to require much more substantial action on a very -- on a very dramatic scale. I completely agree with what Paul Volcker just said to you a few minutes ago about the basic scale of the challenges.

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

And my -- my personal view is, for us to get through this and for us to make sure that recovery is supported by the flow of credit that's -- that's just vital, is that we're going to have to do more to make sure institutions at the core of our system are strong enough that they can lend.

But we're also going to have to provide much more substantial direct support to the credit markets, so that the complicated mechanism that small businesses depend on, that student loan markets depend on, that the automobile finance market depends on, that the commercial and residential real estate markets depend on, that those markets start to come back; and that if we're effective on that front, we should be able to get risk premium down, interest rates down, and get that basic mechanism of credit markets flowing again.

But you had to do both on all fronts. And we -- we have been carefully reviewing a broad range of proposals from consulting very, very widely among experts, both in this country and around the world, about how best to do that. And our expectation is, our hope is, we'll be able to come forward relatively quickly with a comprehensive plan.

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

BINGAMAN: Let me ask about one other problem you're going to be faced with as the treasury secretary. And that is salvaging the -- the automobile industry in this country. And I strongly support doing that. I think it's very important that we have a domestic automobile industry.

There's an article in this morning's Wall Street Journal about the Chrysler-Fiat deal requiring U.S. loans. And very rough -- rough frame, as I understand it, basically they're saying that Chrysler has to get another $3 billion from the government in order for Fiat to go forward with this. Fiat will acquire a 35 percent interest without putting any cash in. And then at some time in the future, assuming that the company is -- is making profits, Fiat will get another 20 percent for $25 million.

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

GEITHNER: Senator, you're absolutely right that we're going to have to, as we move forward, try to make sure that any assistance the government provides is assistance in support of a comprehensive restructuring that will leave the American automobile industry in a stronger financial position, where they can be profitable and healthy without government support going forward. And our judgment is that that's going to require very, very substantial changes by all stakeholders in these companies.

And we are in the process now of putting together a team of people with expertise in manufacturing, in restructurings, who understand how these labor contracts work, so that we can give the president the best advice and come to you and give you the best -- plan that meets that test.

But you're absolutely right to emphasize the point that assistance should come with conditions that give us confidence, that we're going to leave the industry stronger, more viable in the future, without having to rely on government support.

BINGAMAN: Thank you.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator Bingaman.

Senator Hatch, you're next.
HATCH: Well, thank you, Mr. Chairman.

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

Let me just say I'm sure you're as concerned about the prospects of trillion-dollar deficits as I am -- trillion-dollar-plus deficits. It seems to me that, as soon as we get the economy turned around, we need to space spending in a very serious way. To me, and to anybody with any brains, it seems maybe we have to engage in entitlement reform, Social Security, Medicaid, Medicare and energy.

That's where the -- that's not necessarily entitlement. But that's where the dollars are. And that's where we're going to need to find changes, if we're going to stop our country from going down the drain. But what are your thoughts on entitlement reform and on budget reform as well?

GEITHNER: Senator -- Senator, I think you framed it exactly right. We start this process today with the deficit that the CBO estimates at in the range of $1.2 trillion.

It is absolutely critical, to the efforts to get the economy back on track, that we give the American people and investors around the world confidence that we're going to have the ability and the will, working with the Congress, to get our fiscal position back down over the next five years to a sustainable position; but also, that we're willing to start to take on and find a consensus, on a bipartisan basis, for putting Social Security and Medicare on a more sustainable financial position longer term.

I think we have to do both those things together. Harder to do, given the magnitude of the deficit we start with. But the recovery will not be strong enough unless we can make more credible, than we've been able to do as a country over the last several decades, our willingness to put our fiscal position back to a sustainable position. And that requires, not just a credible set of commitments the next -- over the next five years or so, but that we begin the process now of taking on entitlement reform.

The president is consulting with the Congress on how best to do that. We're looking for a mechanism that offers the best prospect of getting bipartisan support early. And we very much like to work with you and your colleagues on how best to do that.

HATCH: Well, thank you. Many on both sides of the political aisle believe that our corporate income tax rate -- I'm one of them -- which is among the highest in the industrial world is a major hindrance to our national and international competitiveness. I have two questions about this.

First, do you agree that our -- or disagree that our corporate tax rates should be significantly reduced? And secondly, you know, secondly, some policy-makers, including my friend, the chairman of the Ways and Means Committee in the House, Charlie Rangel, believes that the corporate tax rates should be reduced, but only by eliminating other so-called corporate tax benefits, such as the research tax credit.

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

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

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

The president, as you know, is committed to making the research and development tax credit, the -- the R&D tax credit, permanent. A lot of merits in doing that. But again, I think that very important, as we look at how to address a broad set of changes in the tax front, that we're going to be forced to address in the next few years, that we give adequate attention to improving the overall corporate tax system, so that it makes sure that American businesses are as productive as possible going forward.

HATCH: I get many complaints from my folks out in Utah, who essentially are businesspeople, that our corporate tax rules place American firms at a disadvantage when it comes to competing abroad. As you know, we're one of the handful of developed nations that tax home-based entities on their income,
regardless of where it was earned. And while most other developed countries employ a territorial system that taxes only that income earned within their borders.

Now, do you think that moving towards territorial taxation would make it easier for our companies to compete -- to compete globally and also simplify the corporate tax system in the process?

GEITHNER: Senator, that's an issue I'm going to have to think more carefully about and would welcome to chance to -- to listen to you and your colleagues about exactly how we navigate through that, through the questions.

But I -- I think you're right. You have to look at the entire package of incentives the tax code creates in the context of what other nations do before we can make a judgment about what set of reforms are going to try to meet this basic test, which I think we all committed to, of how to make sure that American businesses are as productive as possible.

HATCH: Well, thank you.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator Hatch.

Senator Kerry.

KERRY: Thank you, Mr. Chairman.

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

The levels of negligence and the sins of commission that -- of those responsible for the management and regulatory oversight of our financial system are absolutely staggering; so much so that the former chairman of the fed, for whom the committee and the country have great respect, Paul Volcker, just said to us and to the country that the financial system is broken. And he said that this is the mother of all financial crises.

You can't really put it more starkly than that. And it's in that context that I want to, sort of, put something to you. I think that events have already overtaken what the House of Representatives has passed and what is currently on the table in the context of a recovery package. And I don't want to repeat -- I don't want this committee or the Congress to be put in the position of repeating any of the mistakes that have been made.

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

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

I am convinced, as I think the president is and you are, that we're on the brink of an entirely new economy, if we invest correctly, and if we move towards the technology, education, research, investment side, with the -- with the full level that it's going to take to open up those opportunities. But none of those opportunities are going to properly open up if a whole bunch of the money that we're putting in continues to buy what I'll call polluted assets, fundamentally.

We're propping up shareholders. We're propping up fundamentally insolvent institutions. And unless those institutions clear their books of those toxic assets, we're simply going to compound this crisis.

KERRY: So, you know, I think that -- you know, I don't think that the -- first of all, the -- the -- I don't think the package is large enough. We just heard Mr. Volcker talk in terms of $1 and $2 trillion, and I think you're not going to restore this process unless you come with a package that is comprehensive, ultimate in a sense, where the marketplace says, sort of with a -- with a breath of relief, "This is going to do the job. Now I dare to lend. Now I have books clean enough to lend."
And, in fact, I think you can advantage the American banking system very significantly by moving aggressively in the global marketplace to be the first to do this and -- and finance it through the Treasuries, et cetera, and -- ultimately winding -- I think being less expensive to the American taxpayer as a result.

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

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

BAUCUS: Mr. Geithner, very briefly. It you could, answer that question in negative 20 seconds, which is a short way of saying we've gone 20 seconds beyond the allotted time, but please answer very briefly.

GEITHNER: Senator, I share...

KERRY: Well, with all due respect, Mr. Chairman, there are lots of questions that ended at 00, and the answers were provided afterwards.

BAUCUS: Yes. Well, we're trying to -- there are a lot of senators who have a lot of questions to ask, and I'm trying to do -- be fair to all senators.

Mr. Geithner. GEITHNER: Senator, I share the concerns you expressed, agree with the objective you set out. We're going to try to meet that objective with a plan we lay out to the -- to the Congress and the American people. The challenge is how to do it in a way, as you said, that's going to work and give people confidence that these institutions have the strength and the ability to lend going forward.

But we're going to have to do more than just try to make sure that banks are strong enough that they can lend. We're going to have to make sure that -- you know, we have a very complicated financial system, and the capital markets are central to how our economy works. It's a very delicate, complicated balance, but we need to make sure, as we stabilize the banks, make sure they're strong enough to lend, that we're doing things that are going to be effective in getting risk premia down, interest rates down, and credit flowing again through those capital markets, and we're going to try to do both those things at once.

So I -- I agree with your concerns and your objectives.

BAUCUS: Thank you.

Thank you, Senator.

Senator Snowe?

SNOWE: Thank you, Mr. Chairman.

And welcome, Mr. Geithner.

Obviously, the role of the Treasury Department is to be a steward for both the U.S. financial and economic system, both of which are in simultaneous crisis. Obviously, your role as secretary would be to try to pull us out of this morass and, certainly, the breadth and depth of your experience would suggest that you certainly have the credibility and the experience to move forward, given the fact that you've worked for three different administrations, five Treasury secretaries.

The leadership also requires translating vision into action into executing solutions, and I want to just explore for a moment your role in the credit derivatives market, and it's been mentioned -- and impressively so -- that you identified the magnitude of that crisis, and the problems developed because it was systemic and there's no way to identify the -- you know, not only the size of that market, but in the event that there was a serious crisis, whether or not that could be sustainable, our system could sustain that. And you gave a series of major speeches since 2004 regarding credit derivatives and, ultimately, in June of 2008, you called for comprehensive regulation and financial overhaul.

But what I'd like to know -- because you obviously had a major bully pulpit, Wall Street within your jurisdiction -- what actions did you specifically take, and who did you go to? Did you go to the board of
governors, the Federal -- chairman of the Federal Reserve, to the Treasury secretary? What would you have done 20/20 hindsight, and how would you have done it differently? Why didn't you aggressively pursue it here -- I don't know. Maybe you did -- with the Treasury secretaries or to the Congress?

So I'd be interested in knowing that because I look at the issue of the credit derivatives. We look at what happened on Lehman's. It was a different explanation from the Treasury secretary, the chairman of the Federal Reserve, and -- and spokesmen on your behalf. I don't know whether or not that's been verified, but the fact that Lehman's was allowed to collapse because the -- it was already absorbed by investors, and then -- or the fact that you didn't have the federal regulatory authority to do anything about it. And finally, you know, the inability of, you know, purchasing toxic assets on -- which was the original intent and purpose of the $350 billion that we provided last long -- didn't -- failed to happen.

So when I look at that entire picture, it concerns me because that is what's creating the confidence, I think, about where we stand today, the confidence in our system, and the confidence to get it right. And, actually, I think we did work with speed and force last September, much to the objection of the American public, frankly. So I would like to know from you exactly what you did in that market, why on Lehman's and, third, on the toxic assets.

Thank you.

GEITHNER: Thank you, Senator.

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

And what I did was to get the major institutions in -- who are responsible for about 95 percent of this market in the room at the New York Fed with their primary supervisors from around the world, first effort done on this scale, I believe, ever, and we got those institutions to commit to clear, concrete commitments to substantially strengthen that infrastructure and put it on a stronger foundation going forward, and the changes made over that period of time, starting in 2004, 2005, were very, very effective in trying to make sure that the infrastructure in this critical market was strong enough, stronger than it was before, so that we could withstand a shock of this magnitude.

Now, as important as that, I worked with the SEC and again with the lead supervisors of the major global firms around the world in -- from Switzerland, from Germany, from France, from the United Kingdom, and from Japan to make sure that we were trying to encourage very substantial improvements in risk management so these firms had a better sense of the risks they were exposed to in credit derivatives and a broader -- broad range of other complex financial products, and those efforts, I believe, had a lot of traction. They made the system stronger. They could have had more traction, of course, and if -- and if more had been done earlier and had been more responsive to those efforts, then this crisis would have been less severe. But those things were very important, and I believe they were very effective, and I think that market today is on a path to the point where it's going to be -- it's going to have the basic strength and resilience you would expect from a market that important.

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

BAUCUS: Briefly.

GEITHNER: OK.

BAUCUS: Yes, briefly. Briefly.

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

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

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

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

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

BAUCUS: You're going -- shorten -- shorten it up a little more, please.

Thank you very much.

Thank you. SNOWE: Thank you.

BAUCUS: Thank you.

Senator Wyden, you're next.

WYDEN: Thank you, Mr. Chairman.

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

GEITHNER: Senator, if confirmed for this office, I will work very hard with the responsible regulators in the
United States and around the world so that we have a set of accounting requirements and disclosure
requirements that do a better job than we've done to date in trying to make sure that investors in these
institutions have a better sense of the risk they face. But I -- I just want to point out -- and this is critically
important, but it is very hard to do in an environment with this much uncertainty about the scale of the
recession ahead and the losses that will come with that.

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

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

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

GEITHNER: Senator, in that case -- and I would say across the financial system -- nobody that has been
part of this system as a member of the board of an institution, as a chief executive, as a supervisor, as a
regulator, as a central banker, as a treasurer, as a finance minister -- nobody who's been part of this system
cannot look at this crisis and not be deeply, deeply uncomfortable by the failure of the basic checks and
balances in our system, and to fix this going forward, I believe it's going to require -- I'm going to come to
to your question just quickly. It's going to require very, very substantial reform. WYDEN: What -- what would
you have done personally differently, if anything, because it seems to me the Fed had significant supervisory
authority there? The alarm bells were going off, and I want to know what you, looking back, would have done
differently.

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

Supervision plays a critical role, and supervision could have been more effective, and our system created a
very complicated set of accountability and responsibility among the myriad of supervisors and regulators
responsible for overseeing bank holding companies, and part of the failure in the checks and balances was...
WYDEN: Should your supervision have been more effective?

GEITHNER: Absolutely.

WYDEN: Thank you.

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

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

GEITHNER: Senator, a very important question, and I absolutely share your concern. I think across the country you're seeing exactly the same thing, and I think the critical test of everything we do is -- among other things, is it -- does it result in more access to credit on appropriate terms for small businesses across the country. The president believes that -- and I share this belief completely -- is that you have to do very, very substantial support for overall growth in demand, and the president's program does not just -- not just does that, it has some very important targeted tax benefits for businesses across the country which will very -- help meet those concerns.

GEITHNER: But it's going to be absolutely important to try to make sure that these programs' support for the natural system is made available to small banks across the country that play such a critical role in our communities -- and -- and that we do enough quickly enough to try to get the basic markets that are central to small business lending going again.

And I -- I think that there's a lot that we can do in that area. Open to ideas, look forward to suggestions, happy to work with you on it, but I think you're right to emphasize its importance, and it will be the critical tests fundamentally of whether we are -- our -- our program is working.

BARRASSO: Thank you, Senator Wyden.

Senator Kyl is next, but he's not here now.

Next after Senator Kyl, Senator Schumer, but Senator Kyl assuming his time when he returns.

Senator Schumer?

SCHUMER: Thank you, Mr. Chairman.

Thank you, Mr. Geithner.

First question. Senator Kerry was talking to little bit about good bank, that bank. It's appealing, because the alternative seems to be almost the death of a thousand cuts -- keep marking down the assets further and further.

The thing I worry about with it is cost. I did a little calling this weekend to people who would know, and they said it could be $3 trillion, $4 trillion, if you did that whole good bank, bad bank across the board, which creates great worries for the dollar and for you know inflation down the road.

I mean it just shakes our financial system -- something that large. A., do those estimates seem out of the ballpark to you? And even if it's a little less than that, do we have worries in doing this in terms of the cost of fact on the dollar, et cetera?

GEITHNER: Senator, the good bank, bad bank type solutions have been present at the solution to most financial crises around the world. And there it's very important that you -- we look carefully at whether they're going to be as effective in this context as they have been in some past cases.

But you're right to say they are enormously complicated to get right. And we want to be very careful that not just we're using the taxpayers' money most effectively with the most potential impact and leverage on the financial system, but also that we do these in ways where the taxpayer and the government understand the risks we are taking, that the system is going to be managed with the best possible return going forward.
And it is a enormously complicated set of questions. But those are among the questions and options that a team of people -- very smart people who are experienced -- are looking at today.

And it is possible that something, that it will be part of the solution going forward. But I don't want to today provide any more details on how best we can navigate this...

SCHUMER: Of course, these are serious considerations, I would presume.

GEITHNER: Right. You know we -- we want to have the best impact on the financial system with the least potential cost to the taxpayer with the least potential risk. And finding that balance is going to be hard.

SCHUMER: Next question. We do have to get to the bottom of the real estate dilemma probably more than anything else here. I've always felt you need both the carrot and the stick. Lots of carrots have been proposed without any sticks, and not much has happened, whether by Secretary Paulson, Senator Dodd, Congressman Frank.

The stick that I think works best is bankruptcy, the talk about bankruptcy reform. We've now had a few banks become supportive of this. A., what's your view? I know President Obama has been for this.

B., what about putting it in the stimulus?

GEITHNER: Senator, the president is supportive of changes to the bankruptcy code in the more area. He recognizes -- I know you do, you and many others -- that doing that is -- requires enormous care, because it's very important that we make it more likely, not less likely, we get private capital to come into the financial system. That's going to be absolutely essential.

And we need to make sure we reduce uncertainty about the basic rules of the game that govern property rights and contracts going forward.

So we're going to be supportive of trying to do that in the most careful possible way and open to suggestions and if confirmed, of course, will work with you and your colleagues about what the best advice for doing that is.

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

SCHUMER: Right.

Third question. We just went through the second round of the TARP. The greatest criticism I think from both sides of the aisle is you put the money in -- Senator Wyden mentioned this in terms of small business; it's across the board -- you don't see much lending going out.

That's probably because the banks are in such a weekend condition that they are holding onto their capital for dear life, because even if the dollar is now they think is valued at $.40, it could go down to $.20, and if they lend based on the $.40, they may be high and dry.

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

GEITHNER: Very important question, and it's the center of the considerations as we think about the planet want to present to the American people.

I want to start just by pointing out something you said, which is that without the actions that Congress made possible in the fall, we would've seen a much more dramatic contraction of lending across the entire financial system.

Avoiding that was absolutely central. But moving forward, we're going to try to actually try to make sure that the banks that are at the core of the system are strong enough that they can provide the credit necessary to get recovery going again.

But we're also going to have to provide much more substantial support to the capital markets, credit markets, more generally, because that basic infrastructure is central to the basic mechanics of the markets that support corporate lending, small and large business lending, to the commercial and residential real
estate markets, to student loan markets, auto finance markets.

And our view is you're going to have to do both. And again, the key lesson is you try to -- you have to do it with enough force and clarity that people see impact quickly. And -- and frankly, we have to make it clear that were keep at it until we fix it.

SCHUMER: Thank you.

BAUCUS: Thank you, Senator.

Senator Bunning?

BUNNING: Thank you, Mr. Chairman.

Welcome, Mr. Geithner, to the committee. Of the many positions in the federal government about to be filled, the treasury secretary is among the most critical today, obviously.

We are confronting a severe financial panic, and one false move by the secretary of the treasury could result in years of stagnation and high unemployment.

Even before the disclosure of the nominee's tax problems, I had serious reservations about this nomination.

Mr. Geithner has been involved in just about every flawed bailout action of the previous administration. He was the front line regulator in New York when all the innovations that recently have brought our markets to their needs became widespread.

He went along with the flawed monetary policy decisions of Alan Greenspan and Ben Bernanke. He failed to cite China for manipulation of its currency, and he stretched the law beyond recognition to bail out Bear Stearns.

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

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

The committee has known about these matters since December 5th, but it was not until about one week ago that the information was shared with the members of the committee.

Soon afterward, the chairman sought to hold a rushed confirmation, to which I and others objected. This hearing is still rushed, and my staff has only limited time to access the relevant information now the chairman wants to markup the nomination tomorrow.

As far as I know, the committee has never interviewed the IRS personnel involved in the tax case, and none of the witnesses has been made available to the staff or committee members.

That is unacceptable, in light of evidence that the IMF clearly explained his payroll tax obligations, as acknowledged by the nominee himself.

And Mr. Geithner's failure to pay the Social Security and Medicare taxes he owed until he was to be nominated is hard to explain to my constituents, who pay these taxes on a regular basis.

I could spend a lot more time explaining my concerns about this nomination, but I was to get them later in questions that I will ask the nominee. Thank you.

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

I also say that all the relevant materials have been made available, I assume at the staff level, to all the senators for a good number of weeks.

And given those two competing factors, it's the chair's judgment that this the proper speed within which to
take up the -- the hearing, and...

BUNNING: Could the chair answer me one question?

BAUCUS: Certainly, and -- and also hopefully the nomination...

BUNNING: Well, was the -- was the meeting notice proper?

BAUCUS: The meeting was noted properly.

BUNNING: Noticed in time -- I mean in a timely fashion.

BAUCUS: The meeting was noticed properly.

BUNNING: That is not what I was told.

BAUCUS: Well, I regret that, then. It's -- we're -- we're...

Next -- Senator Roberts, you're next.

(UNKNOWN): No, we...

BAUCUS: No, after -- after...

(UNKNOWN): It doesn't matter whether you're Republican or Democrat how you...

BUNNING: I won't switch parties yet, but...

(LAUGHTER)

(UNKNOWN): Thank you.

BUNNING: No, but...

(UNKNOWN): I don't -- it's not a partisan thing. We've...

BAUCUS: No, no, no, no. Not exactly. It's all arrival. It has nothing to do with back and forth and party. It's always -- it's all arrival, and you're the next -- the -- the next who are entitled to speak.

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

Mr. Geithner, thank you very much for your willingness to serve in this very, very difficult situation. We had a good talk in my office, and I -- I find you very engaging and certainly felt that you knew what you're talking about, thought it was very educational.

And I thank you for your phone call later, after the tax issue came up, in which you're very contrite. Basically, I'm not going to split the shingle on the tax measure.

But I do want you to know that after that was reported, my phone lines lit up, and they are also now lighting up in my offices in Kansas and here, why we are considering a nominee for treasury secretary, who would not pay the taxes that he owed.

And I'll leave it there, except to say that if you did not pay these taxes simply because it was a matter of oversight and confusion, Mr. Chairman, we have a wonderful example I think and the best case yet for undertaking reform to make the tax -- the tax code simpler for -- for all taxpayers.

And I was intrigued by the suggestion of the Wall Street Journal that we use this as an impetus for a tax holiday for all Americans, who have made a mistake and didn't -- do not want to engage the IRS in the briar patch and -- and end up with some kind of a penalty. So maybe you can call for that, once you're confirmed.

You're going to be confirmed, and you can work with the president. We can have a tax holiday for all Americans that have these kind of problems.
Now, basically I -- I know, as somebody has said -- I think Senator Wyden -- over the past year you've been the architect or played a role, along with Secretary Paulson and Mister Bernanke, in the structuring of several financial investor rescues, including the AIG.

And last week, as you well know, the Congress approved the release of the remaining $350 billion of the TARP funds.

I opposed the creation of the TARP program and the release of the second round, because I have very serious concerns about how the first $350 billion was spent. I'm not sure today yet how that was spent.

If confirmed, I would like to know what steps you will take that will assure Americans that -- and our public -- that their hard-earned dollars are being used wisely and appropriately under the TARP.

And here's -- here's really what I'm getting at. And that's a lot like what Senator Wyden was pointing out, Senator Kerry was pointing out.

I know what the government can do. The government can do a lot of things. The government can furnish our national security, and we all know how that's done. And the government can really do a lot in terms of infrastructure and rebuild a lot of things, and goodness knows in this committee and in -- in the Congress we know we are a giant income transfer machine, and we figure out who we take from and who we give it to, wrapped with a lot of strings and a lot of cost.

Now, that's the entitlement programs that you and the president have indicated you would like to reform, and I certainly join you in that.

But I never found out from Mr. Paulson and Mr. Bernanke in talking personally with them -- and I kept saying with the TARP funds, when the original purpose, and now I guess that's the purpose of the second round -- they're going to take a category of assets, toxic as they are, and put them up there on the playing field, and the government would set a market price.

ROBERTS: How has the government set a market price? And I think that is most unique and most unprecedented, and I never could figure it out. And I said, "Who is going to do this?"

And privately in conversation with both gentlemen, they said, "Well, we'll -- we'll contract it out. We have so many good people." "Well, who are you going to contract it out with?" "Well, maybe folks in academia."

Well, that gave me a lot of -- a lot of good, you know, feelings about that.

And I said, "How are you going to do it?" "Well, we're going to take a -- a sliver of category of assets." "What sliver?" "Well, we don't know yet. And we're going to put that on the playing field."

I said, "Well, how are you going to set a market price?" "Well, we'll set a market price. And if five people come on the playing field and say, 'We're going to buy that,' obviously it's -- it's too high. We're going to have to lower it. Then if we had a market price, we say out there maybe 20 cents on the dollar, and nobody came, we'll have to raise it up."

And I said, "Do we -- do we have the wherewithal to do that?" And there was just questions. And I never go to the bottom of it.

OK, and I don't think the American people know who's doing this, how they're going to do it, and what they're going to do. And I think that's what you have to do in the transparency here, because of your experience and what we're doing with the two TARP's and what I would call the great omnibus bill as opposed to the stimulus bill, which is going to happen. And I now that it needs to happen.

Now, there are a few banks in America that are so large, they're considered too big to fail. I've got 350 world banks in Kansas. Just talked to the Kansas Bankers Association this morning.

Three have said they would like funds. They don't like the conditions. And they don't like the, you know, the stringent, you know, regulations. They certainly don't like Barney Frank's bill, where you're going to sit down with regulators and piecemeal this stuff out. So they don't want to be tossed in the briar patch. And they -- and they have -- they have contributed zero to the economic crisis we now find ourselves in.

I'm just asking you, should these large banks that pose a systemic risk, be broken into separate pieces in order to avoid such large losses? Should they have a different, more stringent set of regulations than the 300 and -- well, 347 banks that I have in Kansas that have not contributed to this problem, but yet find themselves with, to be perfectly frank, FDIC -- FDIC SWAT teams running in, trying to say their performing
loans should be not-performing loans and everything else?

So there has to be at least some forbearance in this. And I know that. But there also has to be stringent regulations.

I am 56 seconds over time. That puts me in, what, about fifth place?

[LAUGHTER]

BAUCUS: I'm pretty sure I'm pretty much equal par for most members of this committee.

ROBERTS: Yes. And I'm not going to ask you two to respond, because he won't let me, number one. And number two, I think you know my concerns. We talked about it. Thank you for your willingness to serve, sir.

GEITHNER: Thank you, Senator. I have heard your concerns. And I -- and I think they're the right kind of concerns.

ROBERTS: thank you.

BAUCUS: Thank you.

Next, since he's not here, is Senator Cantwell. You're next.

No, the committee rule is whoever is in the -- in the -- executive session room (ph) first is the first recognized.

(UNKNOWN): (OFF-MIKE)

CANTWELL: Well...

BAUCUS: You were in there first.

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

And, Mr. Geithner, thank you for being here. I think of your responsibilities for the position you take as an overall system of responsibility and accountability, even though we have various financial entities within the government that are independent. So my questions to you, which I have questions, and I hope you can just answer yes or no, because I have four or five. And I'll try to be brief in describing them too, so that we can --

I'm interested in your overall philosophy about how you're going to approach this from the issues of -- and experiences that we've just had. So my constituents aren't as concerned, or I should say I'm not as concerned about your individual taxes. My constituents and I are concerned about the potential for continued cozy relationship between the federal government and the financial institutions that they are supposed to oversee and regulate.

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

GEITHNER: Yes.

CANTWELL: Thank you. You don't -- I -- I'm glad to hear you say that you didn't have any concerns about using that term. Earlier this week, or a few days ago, there was an article in the New York Times, two different articles. Ms. Schapiro, who was the head of the Financial Industry Regulatory Authority, talking about the Madoff situation and a Ponzi scheme and basically saying that there were some issues there, no inquiries.

But in another article -- this is a January 15th, so I believe they were both the same day as the statements -- that the financial regulatory, FINRA, also, every two years, reviewed the Madoff books. But apparently they missed the fact that maybe Mr. Madoff wasn't actually making trades. Do you think, yes or no, that that is a failure of FINRA?

GEITHNER: I don't think I can give you a yes-or-no question about that, Senator, just to be fair, just because I don't know the details of their responsibilities in that case. But I completely agree that that case...
CANTWELL: So the -- the -- this -- there was -- quote, there was no evidence that the Madoff dealer executing trades for Madoff, that they -- this is coming from FINRA. They're now saying they never -- we don't have any proof that they made any trades. But they basically then said they've also been reviewing their books every two years since they started.

So if they'd been -- if FINRA, this self-regulatory agency, had been reviewing the books every two years, and now we're just coming to the conclusion that they never made trades, is that a failure?

GEITHNER: Well, I understand what you're saying. I think it's absolutely true that the enforcement mechanism failed to prevent this, and to deter it, and to catch it soon enough. That's absolutely true. What I don't know exactly is what their specific responsibilities were, and how well they discharged those responsibilities. But it's absolutely true that the system...

CANTWELL: So...

GEITHNER: ... of deterrence and enforcement failed to detect this and prevent it.

CANTWELL: So was that FINRA?

GEITHNER: Again, I -- I don't -- I'm just trying to be fair. I -- I don't know enough about the details...

CANTWELL: If you're a self --- self-regulatory agency's main purpose is to clean up the industry and make sure there's no problems. And you reviewed the books every two years, you wouldn't -- you don't think that was a failure?

GEITHNER: Well, I'm sure the system failed. What I -- what I just don't know is the precise details of what they did and why they missed what they missed, and what their responsibilities were.

CANTWELL: But from an overall point, wouldn't you say that that was a failure?

GEITHNER: Yes, I would say absolutely that the system failed in the Madoff case, like in many other cases we've seen.

CANTWELL: OK. In -- well, I think that this goes to the philosophy of how aggressive someone is going to be. Given Senator Snowe's question, then about the derivatives market and your answer, which I appreciate what you did at the New York fed in setting up a system to deal with credit derivatives, which I appreciate that. But do you think you missed the growing threat of the credit default swap market, because that was at the same time. And it turned into a pretty big industry. So...

GEITHNER: Absolutely did not miss that. Spent -- it was my life's work in the New York fed, from the beginning, to try to make sure that we were getting the infrastructure in those markets more mature and stronger, and to make sure the institutions that were the center of (ph) those markets were managing their risks more effectively. And everything I've referred to in response to Senator Snowe's question was about the credit default swap market, credit derivatives markets more generally -- derivatives markets more generally, not just in credit.

CANTWELL: So you think the system that you set up established the oversight for credit default swaps?

GEITHNER: Well...

CANTWELL: In -- in an efficient way?

GEITHNER: Senator, what I -- what I said is that we did a range of things that were necessary and effective in making the system stronger. But we're going to have to take a broad comprehensive look at the entire framework that surrounds derivatives and the incentives created for institutions within them. I wouldn't imply and suggest it's done.

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

GEITHNER: Senator, position limits have played an important role in the design of our exchanges. And they play an important role in preventing manipulation and in, sort of, containing risk in the system as a whole. And I believe they should be effective. And I'd be happy to work with you, listen to your concerns on how best to make them effective.
CANTWELL: So do you support aggregate position limits across all commodities?

GEITHNER: Well...

CANTWELL: And across credit derivatives?

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

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

BAUCUS: Thank you, Senator.

Senator Stabenow.

STABENOW: Thank you, Mr. Chairman.

And welcome, Mr. Geithner. You and I have had an opportunity, which I appreciate your talk about what is high on my list in terms of American jobs and -- and manufacturing. I -- I'm not going to get into specifics in terms of the auto industry today.

But we've had, for eight years, an administration that didn't understand or support what needed to be done to keep manufacturing jobs in the United States. And I'd like to know, just in general, what role you see for manufacturing in the economy. And, if confirmed, how you will utilize multiple authorities that you have in order to be able to support this vital industry.

GEITHNER: Senator, I believe, but the president-elect deeply believes, that manufacturing plays a critical role in our economy. We have the most productive manufacturing sector in the world by many measures. That's a great tribute to our strength and resources as a nation.

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

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

And I know the president is deeply committed to try to make sure that we come with a comprehensive strategy, looking across all the provisions of policy instruments we have to try to address the objectives we share. STABENOW: Thank you. And I know specifically that, as you talk about more direct support in the credit markets, we both know how critical that is as it relates to auto loans as well as small business and manufacturers and so on, and being able to get, as many colleagues have talked about, more credit available for small business and for community banks beyond --

We've -- we've only had two banks, as you and I have talked about -- in Michigan that have received any of the -- the TARP funding. None in southeastern Michigan, where half the population is in Michigan. And so I -- I appreciate your other comments on that.

One other question, just to turn -- we haven't really talked about trade much. But that directly relates to manufacturing. The massive interventions by the Japanese government back in 2003 and 2004 to weaken the value of the yen helped to fuel one of the largest bilateral trade deficits in the United States in 25 years. And 2006, the deficit hit $88 billion, two-thirds of which was autos and auto parts.

The misaligned yen subsidized auto exports in the United States for years and frankly contributed to the loss of over 4 million good-paying American jobs in the last eight years. The yen has strengthened significantly over the last couple of months reflecting market conditions. For the past two weeks, it's hovered at about 90 yen to the dollar. And last week, the Bank of Japan governor told the press, quote, "With the recession deepening, Japan could intervene in currency markets for the first time since 2004."

Many of us consider that move by Japan towards intervention at this time to be effectively trying to steal our stimulus. What action would you take as secretary in the event that Japan moves to intervene in foreign
exchange markets?

GEITHNER: Senator, that's as you know a -- not just an important question, but enormously delicate question. And let me just tell you what I believe, and I spent a large part of my professional life in positions at the treasury responsible for exchange rate policy on these issues.

I believe that it's very important for the United States and for the global economy that our major trading partners operate with a flexible exchange rate system in which market forces determine the value of exchange rates. I think that's good economic policy for us. I think it's good economic policy for the vast majority of the other major economies.

And I look forward to working with you and your colleagues on how we address the many concerns that this very sensitive issue touches.

STABENOW: Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator.

Senator Rockefeller, you're next.

ROCKEFELLER: Thank you, Mr. Chairman.

Thank you, Mr. Geithner. I look forward to supporting your nomination. The -- I'm going to ask you something which is off the beaten path, which has not been asked, and therefore needs to be asked, because we're talking about spending money, and recovery, and stimulus and the rest of it. If you have -- if you look at the American electricity situation, you -- you make obviously the first conclusion, if you don't have electricity running, nothing works, including any of your computers.

So you -- you look at where we are now. We have about 7 percent coming from so-called green production, all of which I favored. You have wind, you have solar, biofuels. So, you know, all of that, all of that, add that all up, 7 percent, 8 percent.

You add on nuclear, which has its own particular problems. It doesn't -- nuclear per se doesn't bother me. But the concept of a Tomahawk right down a cooling tower bothers me greatly. And in spite of how many steel rims you put around to protect us. That's about 20 percent. That's considered clean. That's considered clean.

ROCKEFELLER: I spent some time talking with some people that have been appointed by our new president. And he point out this one particular person, Office of Science and Technology Policy, that there are already at work in this country at least two car plants producing electricity from coal that come in at a carbon reduction rate which is right in the middle of where nuclear power is now. And nuclear power doesn't produce carbon dioxide. But, in other words, the emission rate, global warming rate is the same.

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

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

There's no way to talk about a stimulus package, a healthy America, a functioning American economy when you have a 51 percent gap in the pie because we decide, as I'm sure -- you know, I think Congress may try to do. The president has not been friendly towards clean coal. He mentioned it. Whenever he does, I put it in my mind so much that a forget that he hasn't said it very often.

And it's not a very friendly administration that way. One person who likes this idea is Larry Summers, but don't try it on Carol Browner. So we have this situation where you cannot run a country unless you find a substitute for what is now currently not clean coal. Nobody has found it.

We have a 400-year supply in this country of coal, and it doesn't make much sense to me not to try to use American ingenuity, international ingenuity to reduce the carbon emissions to approximately where nuclear power, whatever that is. It's considered clean so, therefore, it's got to be pretty good -- 5, 6 percent,
whatever.

So -- and so my question to you, sir, is why is it that we aren't talking about putting this in the package? Spending the money to answer what, to me, is overwhelmingly the largest -- solve all the bank problems you want. Pay executives fairly. Regulate properly. It won't make any difference if you don't have electricity.

GEITHNER: Senator, I found you compelling on this in private and as compelling in public on this basic question. And if I'm confirmed to this job, I expect to be part of the team of people the president has brought it to help figure out a way to put in place an energy policy for the country that will meet, not just the objectives you laid out, but the broader imperative of using energy more efficiently in a way that's less damaging to the environment.

I think you are right that it's going to be very hard to do, complicated to do. The stimulus package now moving through the Congress is -- it's changed as it's moved through. We're open to suggestions on how to make that package most...

(UNKNOWN): You just got one.

GEITHNER: And I've -- I hear your suggestion and I know you've made it to others. And I'll try to make sure it gets a fair and considered hearing.

(UNKNOWN): Thank you, sir.

BAUCUS: Thank you, Senator.

I note for the record that Senator Bill Nelson is present today and we welcome him here today. The organizing resolution that will -- to provide for new senators to new committees has not yet passed. It will pass later today.

And there are three new Democratic senators that will be on this committee once that organizing resolution is passed. There will be two new Republican members on the committee when that happens. And I look forward to all members -- all new members -- joining this committee in full capacity as quickly as possible. And that will, hopefully, be later today and in future days.

But welcome here today and we look forward to the time when you're a fill participating member, Senator.

I question kind of on my mind and the mind of several others. I think Senator Schumer alluded to it is this dance between taxpayers and investors as you try to get the credit markets move freely.

How are you going to value these toxic assets? What procedures are you going to use? You buy them up and put them into a so-called bad bank? I guess the basic question is: Most people think you'll have to pay a premium if you go that route as opposed to, for want of a better expression, nationalization.

My question is: How are you going to value those assets as you set up so-called bad banks? What procedures are you going to use? It's a big question on the minds of many, many people and, certainly, the minds of members of this committee. GEITHNER: Senator, I agree with you. It's an incredibly difficult thing to do and to get right. And getting it right will be central to the basic credibility of the program.

But what we do will depend a little bit on the precise nature of the program we design and lay out. And I can't give you an adequate response to how we do it well without doing it in the context of the framework of the program we're going to lay out.

You know, obviously, you can look at how the market is pricing similar securities. You can use model-based estimates by independent, third-party evaluators to try to make a judgment about what the ultimate value of these things are. You can listen to supervisors give you your own expectations and these kind of things.

There's a range of approaches you can do. All of them have risks. All of them are imperfect. They all have limitations. Most people, I believe, I think you need to look at a mix of those type of measures. But it's very hard to do but critically important to get right.

But when we come up here and lay out for you the program we think is going to be most effective, we'll explain how best -- how we think we can best solve this valuation problem so that we're protecting the interest of the taxpayers.

BAUCUS: That was going to be my next point. Clearly, there's an impression here in the Congress that taxpayers have not been sufficiently protected in the initial rounds of TARP. And there's this, I think, a very
deep concern that the American taxpayers may not be sufficiently protected this next time around.

And so I will urge you to err a little more on the side of protecting taxpayers because I think that will engender much more confidence in the country. You know, a lot of investors who invested in these institutions and did so, well, at their own risk. The American taxpayers are just trying to help, you know, us help government and help the country function economically and in a prosperous way but in a fair way compared to them.

So I would urge you, actually, quite significantly, to urge you to err on the side of the taxpayers as you set up those valuation schemes.

I have actually -- I'd like to submit for the record, Mr. Geithner, today's New York Times -- I'm sure you saw it -- had a -- these are questions for you. Questions by various people, for example, Charles Rissoti (ph) had a question about the complexity of the tax code. Anna Jacobson Schwartz (ph) asked what criteria are you going to use. And, let's see. I think Mitt Romney asked about how you can effectively regulate financial services industry. Robert Schiller of Yale asked what you mean by "resiliency" when times are normal. And Greg Mankiw asked a question, too; basically, President Obama supports the estate tax; why should a person that leaves his money to his children pay more in taxes than a person with the same (inaudible) incomes who spends all his money on himself? And, of course, there's a question from Roger Morrison (ph) basically asking should a large financial institution incur higher reserve requirement or other regulatory penalties when they become too big to fail. I think it addresses the basic question of too basic to fail, which I think is a huge question our country is facing.

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

Thank you, Senator Grassley?

GRASSLEY: Say, would you do me a favor? The next time Senator Rockefeller talks to you about ethanol, with you remind him that Senator Grassley supports coal gasification and clean-coal technology?

(LAUGHTER)

Mr. Geithner...

GEITHNER: I'll do that. I'll remind him.

GRASSLEY: Thank you. OK.

I'm done asking you about your taxes now.

The treasury secretary plays an important role in setting tax policy. As Finance Committee members, we'd like to get your views on the trends in revenue. CBO reports that, over the past 40 years, taxes as a percentage of GDP, averaged 18.3. In the year 2000, federal taxes averaged 21 percent; a record above World War II levels. Individual income taxes were at even more dramatic levels. CBO reported that to be 10.3 percent on GDP. And I've got a lot of other statistics. But I think you know what I'm talking about.

Now, we hear a lot of criticism from those who oppose the bipartisan tax relief plan of 2001 and 2003. And I want to emphasize "bipartisan." One of the main criticisms is that we cut income taxes too much; that is -- the allegation is that it the bipartisan tax relief plan gutted the federal revenue base.

I would pleased to see Doctors Furman and Goolsbee indicate in their Wall Street Journal op-ed August 14th, last year, than an Obama administration would seek to keep the revenue base at or close to the historic averages of GDP.

So three questions. I'm going to ask them all at once.

Do you agree with Doctors Furman and Goolsbee? Do you disagree with those who argue that the only path to fiscal discipline is to maintain record levels of federal taxation as a percentage of economy? And lastly, do you recognize that there is a downside to future economic growth if we return to record levels of federal taxation? GEITHNER: Senator, I agree that you need to look very carefully at the overall tax burden the tax code imposes on American businesses and workers. And there is a point in which it would cause damage to future growth in a way that would it be troubling, I think, to all of us.
I think you're right that the current level of tax revenues to GDP are slightly below the historical average partly because of the tax changes made over the last decade, but significantly because our economy is going through such a deep recession.

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

But the test for changes in the tax code should be what impact are we going to have on incentive be to save and invest and create jobs. Are we being fiscally responsible? And are we producing a system that's going to be more simpler, easier to comply with, and provide a level of fairness that the American people expect?

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

As you and I discussed in our office, I brag a lot about the fact that I conduct what I consider vigorous oversight of various executive branch agencies. I've done this during my entire time in Congress. I consider it a constitutional responsibility of the Congress.

But I also consider myself an equal opportunity overseer. I believe that sunshine is the best disinfectant regardless of which party controls the Congress or which party controls the White House.

The primary way I conduct oversight activities is to write letters asking detailed questions and requesting documents. Responses to my letter and document requests are critical to doing this oversight. Many federal agencies have a stated policy -- now, this is where it gets down to the nuts and bolts. Many federal agencies have a stated policy that treats information requests from a chairman -- and I was chairman, but now we have a different chairman, a person that works very closely with me, thank God -- of congressional committee and subcommittees differently from a request from a ranking member, like now I'm a ranking member.

Specifically, the policy treats only requests from chairman as entitled to documents otherwise covered by law. But that stated policy finds no support in the text of any other law or Senate rule.

Furthermore, it is the Senate and its committees and subcommittees, and not for the executive branch, to determine who may speak for them.

Given my history of oversight, you can be sure to receive letters from me during your tenure if you're confirmed (inaudible) that like your predecessors, you will commit to responding to my inquiries and document requests in full and timely manner, and that's my question to you.

Would you do that?

GEITHNER: Yes.

GRASSLEY: Thank you very much. I think I'll quit there, because we go into a little -- other things at this point.

Senator Snowe, you're next.

SNOWE: Yes. Thank you, Mr. Chairman.

I wanted to follow up with you, Mr. Geithner, on the original purpose and objective of the rescue plan that we enacted last -- late September and early October, which was, obviously, purchasing of illiquid assets.

And you know, undermining the confidence of the American people certainly was the outcome and the abrupt departure of the Treasury in shifting its objectives. And it looks like it's working in being implemented in an ad-hoc fashion, which ultimately it is.

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

Secondly, in the examination -- the Congressional Oversight Panel's report that was recently issued really was a sharp condemnation and rebuke of the Treasury Department and its failure to provide transparency and accountability.
In fact, in some of the questions it did not respond, did not have a vision of the program. It didn't have a strategy, couldn't explain why, essentially, that they did not purchase illiquid assets, other than saying that it's sort of too complicated, but didn't explain that the fact that they were providing massive infusions of capital into banks was even more effective, or even if it was effective.

So we need some explanations, because now we have passed the additional 350 billion, and I’d like to know how you believe the new administration should proceed.

But more importantly, you know, why did the Treasury Department -- and you were part of that rescue plan design at the outset. You know, why was there a failure to do it?

In retrospect, would it have been more successful and more effective had there been a purchase of illiquid assets from the banks, the toxic assets?

GEITHNER: Senator, let me start where you ended. I do not believe -- well, let me do the affirmative.

I believe that the actions taken in October by the Treasury Department and the chairman of the Federal Reserve and the FDIC were absolutely central to trying to arrest the risk of a much more damaging, deeper deterioration in our financial system.

I think that was the right decision at the time. I think if that had not been done at that time, I think we would be facing, really, a catastrophic failure in our financial system.

So I -- I agree that that was the right set of -- set of proposals to make at the time, but let me just step back for a sec.

I was not secretary of the Treasury then. I’m not secretary of the Treasury now. If you confirm me to be secretary of the Treasury, I will work very hard to meet the concerns you expressed and the American people have expressed here, colleagues have expressed, about how this program has been implemented.

As I said in my opening statement, I think you’re right to say there have been confusion about goals, concern about transparency and accountability, and really concern about, again, whether we’re protecting the interests of the taxpayers, as we have this great obligation to do.

And I will be very careful in trying to make sure that our program meets those basic concerns.

I think it was clear in the summer, if not before, that the United States needed to have three types of authorities it did not have coming into this crisis. One was the authority to put capital into financial institutions.

One was the authority to provide a better, more effective mix of insurance guarantees and perhaps asset purchases to help deal with this broad legacy asset problem across the system. But it was also critical for our country to have the capacity to prevent and deal with catastrophic failures by non-bank financial institutions. All those authorities were very critical.

The Emergency Economic Stabilization Act that you -- that was passed by the Congress back then provided some important new authorities in that area. It was absolutely -- absolutely central.

But -- but again, I think the actions taken then, although they were not primarily my responsibility then -- I think those actions were absolutely central, and they were the most effective use of that authority at that time.

SNOWE: Well, do you understand why -- that it would have eroded the public’s confidence and certainly ours in terms of the Treasury putting forward the primary objective to buy those assets? I mean, clearly.

And the Congressional Oversight Panel was abundantly clear in -- in its criticism of the Treasury Department for their, you know, failing to explain why they did not buy those assets, and didn’t explain why this was a more effective strategy, if it’s even working, which clearly it hasn’t been at this point.

Do you think that it's working?

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

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

SNOWE: Thank you.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator Snowe.

Senator Ensign, you were unable to be here first round, so you're next.

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

I have a couple of questions. first of all, I don't know if you've seen the Congressional Budget Office scoring to the stimulus package that the House put out. One of the -- what I'd like you to address very briefly, if you could, is most of the -- on the -- on the spending side of it, most of the effects are in the out years, especially the investments in infrastructure.

Those are -- you know, the vast majority of them are spent -- on the energy side, only 7 percent, I think, gets spent in the first two years. On the rest of the infrastructure, I think less than half is spent in the first four years.

How does -- with scoring like that, how does that stimulate our economy? Hopefully, two years from now we are not dealing with -- with -- with the financial crisis that we're dealing with today. I think we're all hoping we're out of this thing by then.

So how does that square with actually spending $825 billion to stimulate our economy, which everybody said that I -- the economists that I've read -- you need a large stimulus package.

Well, if a -- only a tiny amount of the stimulus package is actually going into the economy in the next two years, how does that help stimulate our economy?

GEITHNER: Senator, a very important concern, and that's shaped the design of the entire package. You have to look at the entire package, though. The entire package includes a substantial amount of tax incentives that could -- it should work very, very quickly in affecting behavior.

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

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

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

You're also right that the spending provisions -- you want to have -- make sure that they're -- they're going to spend out as quickly as possible, because what we want to see is as much spending -- you know, carefully designed, efficient spending -- go out quickly so that you have more jobs created right -- right away.

We've been -- we tried to be very careful to make sure that the spending provisions, investment provisions, of the tax -- of the package will have that quick-acting effect and to limit the risk that you have what we call very long tails on these basic commitments.

The president and his economic team are looking at a range of ways to try to make sure that we're spending these resources more quickly while still being very careful and very open and transparent about them.
And we believe we're going to be able to do a substantially better job than the government has -- has done in the past in making sure that the infrastructure and energy-related spending that the CBO -- CBO report referred to are going to spend out more quickly than was true in the past.

But you have to look at the overall package as a whole. And the overall package is large and quick in the impact it will have on the economy.

ENSIGN: How -- how will the checks that are sent out by the government in tax rebates -- how will those -- why -- why is it going to be different now than it was last year?

GEITHNER: Two reasons. One is that this is a -- although it's a two-year reduction, it's part of what the president hopes to become a permanent change in -- in taxes for those -- for those workers, American workers. That will help, too.

It also comes in the form of a -- a visible, immediate reduction in withholding that's sustained over that period of time. And because of those two reasons, we think it will have more impact on spending than the package you referred to last year.

ENSIGN: And -- and finally, do you -- just philosophically, when you've studied -- you know, we -- we obviously have examples in the past of -- of severe economic times in our country and other countries -- obviously, Japan during the '80s and '90s and -- and our Depression era.

Do you -- do you think that the New Deal is what brought us out of the Depression?

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

ENSIGN: Doesn't matter -- the consensus. What -- what is your opinion? Because you're -- you're the one who has...

GEITHNER: I share the...

ENSIGN: ... to be -- to be confirmed today.

GEITHNER: I share the belief that it was only when we had in place very, very substantial fiscal stimulus, and a much more effective plan to stabilize the banking system, and a broad change in our exchange rate regime at that time, did we have a set of policies that were going to be effective in bringing us out of depression.

And as you know, that took a very long time. And -- and we got there later than we should have as a country, in part because of some conscious judgments made -- including by the Federal Reserve, frankly -- to pull back from supporting recovery too soon. ENSIGN: How do you explain the 1937 depression within the depression, when a lot of those policies were -- that you've just mentioned were already in place?

GEITHNER: Well, again, I think if you look back in the record, like in Japan, as you referred, part of the problem was a bit of early shift towards restraint, before growth was strong enough.

And that's one of the reasons why the path to recovery in the United States in the '30s and the path in the '90s was so slow and so protracted, and it underscores the importance of doing a lot soon and staying with it.

ENSIGN: Did you -- did you think tax policies had anything -- tax increases during the 1930s -- '37 -- had anything to do with the depression within the depression?

GEITHNER: Well, I do think there were a lot of aspects of the government's response in the '30s that made the recession worse and last longer.

ENSIGN: Did -- did -- did the tax increases in 1937 -- in your opinion, did it add to the depression within the depression?

GEITHNER: Senator, to be honest with you, I have more familiarity with the monetary policy mistakes of the period of time and those in the financial system than I do with the precise dimensions of the -- of the tax and spending decisions then.

Again, I think the overall consensus, which I -- which I share, is that the -- the later mistakes were partly of the nature of moving too quickly to pull back support at a time when conditions were very fragile.
ENSIGN: OK.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator.

Senator Lincoln, you're next.

LINCOLN: Thank you, Mr. Chairman. Appreciate you having us all here today to move quickly.

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

I've also wanted to say I appreciate how much time you've given me to visit in the last couple of weeks, the discussions that we've been able to have.

I think you certainly know from my previous conversations that I've been very, very frustrated with the way that the Troubled Asset Relief Program has been implemented.

And we have handed out tremendous amounts of taxpayers' dollars to our nation's largest financial -- financial institutions, yet there's been little or no relief that's trickled down to mainstream America -- the businesses, the consumers out there, the homeowners.

And that's brought great concern to us in Arkansas. In fact, these institutions have actually tightened their credit with little or no -- no effort to kind of work with those consumers or small businesses.

Small businesses in my state have seen their finances cut off and their loans called under threat of collection. Homeowners have no little -- seen little help in terms of refinancing.

As the head of the -- the New York Fed, you've certainly been intricately involved in the creation and the implementation of TARP, and I know my colleague Senator Wyden asked this question probably in one form or fashion.

But really, reflecting on had you been the treasury secretary during that process, what would you have done differently? And I guess, more importantly, will the program stay on the same track, so to speak?

Or in the coming weeks and -- and what we see ahead of us, are you going to take it in a new direction? And hopefully you'll share with me some of those new directions.

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

And as I said earlier, the critical test of this program will be whether we do enough soon enough to make banks strong enough that they can lend and help make sure that credit is flowing to parts of the economy where it can have the most impact, including to small businesses.

GEITHNER: And we're going to have to do that again with carefully designed conditions to protect the taxpayers and with a set of -- much more detailed set of provisions for transparency and accountability.

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

But we are -- understand and share the concerns with the amount of impact we've seen from this so far, and we'll do our best to try to meet those concerns with a set of reform that will make it more effective.

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

Two last questions, and you can answer them however you'd like in the time I've got.

We desperately need some answers for our small businesses. I've been very concerned about the lack of detail in terms of how we are going approach small businesses and what we're going to do for them out of this TARP money. They need it. They are it the engines of our economy, particularly, in rural states. And it's absolutely essential, I think.

So I hope you can spread some light on the steps that you'll take to make sure that small businesses across this nation will quickly receive some help that they need.

And I guess the last one: Did you see the storm clouds coming? We -- you know, we got this call in September of this unbelievable urgency that the sky was falling and that we immediately had to give this unlimited authority and this huge amount of taxpayer's dollars. And it was amazing because we had met with the secretary of the treasury as well as the chairman of the Federal Reserve months ago and all asked the question, you know, what can we do to help.

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

GEITHNER: Senator, thoughtful, important questions. Let me do small businesses first.

Four quick things. The Recovery and Reinvestment Plan has a set of very important, powerful provisions that will help directly address it the kind of challenges face small businesses. We believe that the resources that -- the authority Congress gave the administration back in the fall and last week should go to community banks so that community banks can also help small businesses to meet their credit needs.

We are open to ideas and looking at and carefully thinking through changes to existing small business credit programs to see if we can make them more effective in this basic challenge. Open to suggestions from you and your colleagues about how best to do that.

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

But as I said, to your colleague, that will be a critical test of the effect of this program going forward. But it's going to require we make sure that banks are strong and able to lend as we try to address the direct credit needs of those -- now, on your second question about the storm.

This crisis began, not in September, but it began back in early '07. And I was at the center of efforts to try to promote a much more aggressive response early, not just on the housing side but through -- but in the financial sector in particular. And I was very involved in trying to make sure that the central bank, in particular, was moving aggressively to make sure that monetary policy was getting to a better place where it could support recovery and that we were encouraging banks to raise capital necessary it play a critical role in recovery.

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

LINCOLN: Thank you.

BAUCUS: Senator Wyden?

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

Now, Chairman Baucus, to his credit, puts the reform of these federal health tax rules on the table. They're on the table now because of the chairman's very good white paper on health care.

And I believe that it's possible to reform the federal health care tax rules and honor the pledges that our new president made on health care. In other words, the new president said I want to make sure everybody can
keep the coverage they have if they want, and he said, I don't want to clobber the middle-class people with new health care taxes.

So my question to you is: When you get your capitol from Tom Daschle, our health care czar, and he asks you whether you’re open to reforming these federal health care tax rules. As the chairman suggests in the white paper, a lot of us are interested in. If Senator Daschle calls you and says are you open to reforming these federal health care tax rule, what will your response be?

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

WYDEN: I appreciate that answer, and we're going to be following up with you. And I'm going to be working very closely with our chairman on that and our colleagues on both sides of the aisle.

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator, very much.

Senator Bunning?

BUNNING: Thank you, Mr. Chairman. Now, I can get to some questions.

Mr. Geithner, precisely, when did you first learn that you were required to pay to the issuance the allowance for Social Security provided to you by the IMF that you applied for each year? Precisely?

GEITHNER: Senator, the first time I learned that I had not met my obligations to pay self-employment taxes was when I received the notice from the IRS auditor that they had conducted an audit of my tax returns.

As I said, I took that extraordinarily seriously. That was the first time I was made aware that I had not complied. Until that point, I felt I had complied. But I want to just emphasize...

BUNNING: I've got a lot of questions. GEITHNER: May I say this one, quickly, thing, though? I went back and looked at all that material. And as I said in my opening, it was very clear. And I had many opportunities to catch that initial mistake. And, of course, if I'd realized earlier I was not complying, I would have moved more quickly to comply.

BUNNING: Well, let me get to that.

I have found that the IMF goes to great lengths to make sure that employees comply with their U.S. tax obligation. One current IMF employee who describes himself as a life-long Democrat called my office to express his disbelief that you did not know about it.

Every year, you had to file a written request for a gross payment to the Social Security tax. I have one of the statements you signed right here. It says, "I hereby certify that I will pay the taxes for which I have received tax allowance payments."

You provided this to the committee. But why didn't you provide it to your accountant when he was preparing your returns for the 2003 tax year?

GEITHNER: Senator, as you said, I provided that form to the committee. I absolutely should have read it more carefully. I signed it each year. I signed it in the mistaken belief that I was complying with my obligations.

And you're right that -- well, this is my responsibility. In those years my accountant prepares my returns, he also did not catch my error. But those are my responsibilities, not...

BUNNING: But you didn't -- you didn't furnish this to your 2003 tax -- you did your own in 2001 and 202.

GEITHNER: I did my own...

BUNNING: And you got -- then you got an accountant.

I believed, Senator, I was giving my accountant all the necessary information to -- so that he could help me prepare my returns. But, as I said, it was my responsibility. And the critical mistake I made was at the beginning that first year. And because I didn't catch it after that, I kept making it.

BUNNING: This individual that called me explained that had you paid self-employment tax but you and your accountant later ignored that advice, can you explain why this person and why did you ignore her advice at the IMF?

GEITHNER: Senator, I relied on the judgment of my accountant. And I should not have relied on that judgment. That is my responsibility, not theirs. BUNNING: Would you have paid your 2001 and 2002 tax had you not been nominated to be the treasury secretary?

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

BUNNING: Let me get on to currency in China and global trade imbalance.

Mr. Geithner, in 2004, you gave a speech in Singapore in which you expressed concern that Asian reserves had reached $2.5 trillion. Last year, we had the largest trade deficit in history with China, and Asian reserves had reached nearly $3.2 trillion.

China's reserves stand alone at above $2 trillion and are counting. And experts say the won is still undervalued by 30 percent. Last year, President Obama co-sponsored legislation that I introduced with Senator Stabenow to create a WTO-consistent trade remedy for manufacturers harmed by currency manipulation.

I also introduced legislation with Senator Stabenow to require the treasury secretary to China for currency manipulation under the 1988 Trade Act. Do you believe that currency manipulation by China remains a significant issue today? And what would you do to address it as treasury secretary?

GEITHNER: I do believe that it is a significant issue. As I said earlier, I believe it's important for the United States and for the global economy that our major trading partners operate with a flexible change rate system and that market forces determine the level of those change rates. I think that's very important.

And I will -- when I was some time to think through how best to achieve that objective -- look forward to a chance to working with you and your colleagues on the committee on how we do that. But you're right to emphasize the president's commitment to this. This is an important issue for the country. It's a difficult, complicated question to work through...

BUNNING: My time has expired, and I've got about one, two, three, four, five, six, seven, eight more questions I will submit to you. And I would appreciate if you responding.

GEITHNER: Absolutely, Senator.

BUNNING: Thank you.

BAUCUS: Thank you, Senator Bunning.

Senator Kyl, your presence has not been noted.

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

BAUCUS: (Inaudible) second round. If you want to... KYL: That's all right.

BAUCUS: If you want the full ten minutes, you can take it.

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

Mr. Geithner, I am a little astonished that you would, in your opening statement, assert that the American Recovery and Reinvestment Plan will meet the test that you set out for its success. The two key elements you discussed are providing powerful and direct support to help people get back to work and to encourage private investment.
Now, the two biggest components of the package are the component for rebate for taxes and the infrastructure and energy spending side. Let's take both of those.

As to the first, you and I discussed in my office -- we quibbled a little bit about the exact percentage, but I quoted you Marty Felstein's statement that recent government statistics show that only between 10 percent and 20 percent of the previous rebate dollars were spent.

You said you thought maybe it was closer to the high side of that than the 12 percent than I had cited. But even if it's, let's say, 20 percent, that, at least, was in one lump sum. People could see the $500 or $600 that they received.

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

GEITHNER: Thank you, Senator.

Our view is that this is designed in a way that will help improve the prospects that a larger portion of the tax benefit is spent. And there's two reasons why that's the case.

The first is that this is part of a -- it's an initial down payment on a reform that the president would like to make permanent and paid for. And our hope is that with the expectation this is going to be an enduring change in withholding tax treatment for the Americans that are eligible, it will have a more powerful effect on spending.

GEITHNER: The second reason is that because this is designed in a way -- rather than getting a one-time check in the mail initially, lump sum payment, people will see a change in withholding statements every week. And they'll have a reasonable expectation that will be continued.

And for those reasons, we think it will have more impact on spending behavior and have more effectiveness than the stimulus package that was designed early -- earlier last year.

But I -- I understand the concerns you've raised about it. None of us will know for sure what impact there's going to be, but it's designed very much to address the concerns it began with.

KYL: And I -- and I appreciate that. It's -- it's all a guess, and let me just state the statement that Larry Summers made. We discussed this as well.

He wrote the following: Investments will be chosen strategically based on what yields the highest rate of return for the economy.

And it -- it seems to me that this fails to meet that test either.

Let me turn to, though, with that specifically in mind, the CBO analysis of the infrastructure. And you're familiar with that analysis and report of just a couple of days ago.

For those who may not be familiar with it, just a couple of -- of their conclusions. CBO estimates that less than half of the construction funds in the stimulus bill will be released into the economy over the next four years -- less than half within the next four years.

Less than $4 billion will reach the economy by September of 2010. So most of the infrastructure money wouldn't even hit the economy until we assume it is already beginning to recover.

And on the energy side, which is also high in terms of spending, CBO estimates that only seven percent of the energy money will be spent within a year and a half period of time.

How is that going to provide stimulus?

GEITHNER: Senator, I had a chance to respond to some of those concerns when you're out of the room, but I -- so but I just want to repeat the point that I said before.

I think you have to look at the overall package. And the overall package of tax changes and investments and aids to states in our judgment, based on very substantial consultations with a broad range of economists and people in the Congress, we believe that package will offer very substantial support quickly to the economy as a whole, and...
KYL: Excuse me. There's something -- if I could just interrupt -- so there's something in there that will -- I mean you acknowledge CBO's analysis. I guess you have no reason to contradict it.

GEITHNER: No, I want to -- I want to respond on that...

KYL: Well, would you? That's what I'm asking. I'm going to get to the other items. And what you're saying is there are other items that might kick in earlier. I'm going to ask you what they are specifically. But tell me why you think CBO is wrong, please.

GEITHNER: I -- I have not read very carefully the CBO concerns, but my colleagues have. Our judgment is that we can do a much better job in the government-centered tasks and getting those resources out the door quickly.

And of course, we want to be very careful as we do it -- not to waste resources -- but they were making a set of judgments based on how this had begun in the past, and the president has said publicly, and his team is looking at actively, at ways to get those resources out the door more quickly.

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

KYL: So -- but here's the point. This is such a big -- it's not an order of magnitude, but it is such a -- a significant difference from what you're trying to accomplish -- less than half the money over a four-year period.

Doesn't it seem implausible to you that marginal changes in how you can improve getting the money out the door could conceivably make up for that kind of a deficit?

GEITHNER: We think we could do substantially better than the CBO estimate suggests. The president wants his team to do better. He's committed to it. We're going to do everything we can. We're open to suggestions on how best to do that.

But we -- we share your concern that in designing the package -- again, we want to have strong force quickly. And again, I think if you look at the overall package...

KYL: OK. Let's get to the overall package, because you're kind of falling back on the defensive, well, maybe this isn't going to be very immediate, but there are other things.

How do you transfer payments to states? How does an increase in Medicare or Medicaid spending give you the return on investment that Larry Summers was talking about in terms of jobs and investment?

GEITHNER: Senator, I understand your concerns about those proposals. But our judgment is those proposals will help reduce the need for states. Without that support, states will have to make very, very substantial reductions in critical government services at a time when the economy cannot withstand those effects.

So that's an area where we believe you can have very, very substantial support to the economy, and both in terms of employment and expectations for businesses quickly.

KYL: Well, the classic Keynesian concept here is that where there's been a -- a deficiency in spending or a gap in spending, that government in times of recession needs to fill that gap with more spending. And -- and that's the idea here.

But states and localities have been increasing their spending dramatically over the last four or five years -- in 2008 by an average of seven percent. And in a lot of states it's a lot more than that.

So it's kind of hard to -- to argue that more spending capability for the states is going to fill a gap spending by the states and localities, isn't it?

GEITHNER: Well -- well, Senator, in the absence of those provisions, I think it is absolutely clear states will have to cut back very, very dramatically. And that will raise unemployment and reduced demand for goods and services created by American businesses.

And so I think it really is essential to do and should be a part of, and would -- would be I think a part of, any
credible fiscal plan to help bring recovery back.

KYL: So -- so rather than encouraging states to try to become more efficient and to cut back on things that in -- in tough times you just can't afford to do, you intend to send them the money so they want have to make those tough decisions.

GEITHNER: No, I don't think that's a fair way to characterize it. I think, of course, we would like these provisions to come with conditions that will improve confidence in their citizens that this money is going to be used wisely.

But the critical priority for the country now I think is to make sure that the government is providing enough support to get growth back on track faster. And I think these aid to states provisions are a absolutely important part of that program.

KYL: Well, one of the ideas with the bailout -- I mean this is essentially what that would then be -- is that these be loans. At least the American taxpayers get their money back. Would you be supportive of -- of conditioning some of the support to the states and localities on being eventually repaid to the federal taxpayer?

GEITHNER: Senator, I -- I think that's an interesting idea. I don't know whether that's practical, but I want to reinforce the president's commitment that as these provisions are considered by the Congress, that we are open to suggestions on how to design this package in a way that's going to be most effective in achieving its objective of getting the economy back on track.

So we will be open to any suggestion. We've tried to consult very widely. And if there are ways we can meet this objective more effectively, we'd like to try to do that.

KYL: OK, well, that's a suggestion. Now, what's your response to it?

GEITHNER: Senator, I -- I don't know if that's practical in this context. We tried to take advantage of the fact that there is an established set of mechanisms Congress is used in the past to provide aid to states in recessions. We're trying to use those, adapt them to make more effective.

I don't know why that idea has not been adopted in the past by the Congress. I'd like to think about it a little more -- a little more carefully, and... 

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

GEITHNER: That's correct. That's correct, but again the overall thrust is try to make sure that states do not -- are not forced to cut back dramatically at a time of national weakness and turmoil.

KYL: One of the things that the president announced as a goal was that about 40 percent of the so-called stimulus package would be tax relief.

Now, one could argue about whether -- and in fact, the way it's scored, the -- the proposal on -- on the tax rebates is scored as spending.

But what -- what percentage of the package, as introduced in the House of Representatives, do you estimate to be...?

BAUCUS: If you could answer that fairly briefly, too, I'd appreciate it.

GEITHNER: Sure.

KYL: A percentage number.

GEITHNER: Senator, I'm not sure I can get the percentage exactly right, but somewhere in the realm of 40 percent is in the provision that we would call tax incentives and tax changes. KYL: Well, would -- 40 percent?

GEITHNER: Well, I'm -- I don't want to -- I do want to get the math wrong, but a substantial part of the package, the framework we propose, and I think what emerged from the House's committee now is consistent with that, has a very substantial part in the form of tax incentives and tax changes.
Mr. Chairman, I've had the equivalent of two rounds. I'm willing to wait for my third round.

BAUCUS: OK. Thank you.

Senator Cantwell?

CANTWELL: Thank you, Mr. Chairman. Thanks for having a second round.

Mr. Geithner, I wanted to emphasize how important the small business issue is and look forward to working with you, and we will have suggestions.

A bank in our state in Vancouver, Washington, was just taken over by the FDIC. A bank from Oregon, who had just received $214 million from TARP, obviously, to help stimulate loans -- they are taking over the deposits of the Washington bank, but it seems like the line of credits small businesses are frozen.

So this is a real issue, where these small businesses during this time period -- and you mentioned obviously the asset-backed securities and lending program -- but some of those things aren't in place. They are not in place right now, and so all these larger banks are getting the lifeline.

These small businesses are not getting the line of credit that had previously established, so we need to act rapidly to fix that problem. So we look forward to working with you.

I want to go back to the regulatory reform issue, because it's so important. A former SEC chairman, Mr. Leavitt, basically describes the CMFA, the credit -- I mean the Commodities Future Modernization Act -- as -- at least in the was talking about derivatives and credit default swaps -- as a failure.

Would you agree?

GEITHNER: Senator, I -- a lot -- a lot can...

CANTWELL: I'm sorry. I'm sorry. He used the word "mistake."

GEITHNER: It was a mistake? I don't think I agree with that, but I do agree that we're going to have to take a very careful look at the whole comprehensive framework of requirements, regulations, constraints and incentives that exist for the institutions that play a central role in those markets.

We want to make sure that the standardized part of those markets moves into central clearinghouse and onto exchanges as quickly as possible, and that's not happening because of the work we supported.

And we will look at a range of other changes, too, to try to make sure these -- these market functioned the way we need with more benefit in terms of capacity to hedge and less risk to the system as a whole.

CANTWELL: Why -- why wasn't it a mistake?

GEITHNER: Senator, I guess I think that it's just a more complicated set of problems that were created. We got -- we have a situation where institutions at the core of the system did not understand and adequately manage the risk they faced and exposures through those products and others.

They did not understand the effects these things had on a bunch of other important markets for credit and equity markets as a whole. And I don't think that -- but -- but again...

CANTWELL: So do support the full regulation of credit default swaps?

GEITHNER: I will support taking a careful look at how to put in place a more effective framework of regulation over the participants in those markets and the markets themselves.

Open to suggestions on how best to do that, but we need to get it right. It's going to be a really complicated, difficult thing to do, and...

CANTWELL: Well, what -- what scares you when I say regulation of those -- of those tools on the exchanges? What -- what's bothersome about that?
GEITHNER: Well, as I said, I'm fully supportive of moving the standard part of those markets onto central clearinghouses and exchanges. I think that's really important for the system. It will help reduce risk and the system as a whole.

I think that's necessary, but not sufficient. Again, we're going to have to look at the incentives that capital firms create, for how much exposure to these instruments institutions hold.

We need to look at how the hedges are treated by -- through regulatory capital and accounting. It's a enormously complicated set of questions. And my resistance is not to the objective. It's just that I want to make sure we get it right.

CANTWELL: And my resistance here is that I am tired of these exotic tools. In fact, there's nothing exotic about what's happened to our economy. There's nothing exotic about those who have lost their jobs. And this is just the exotic tools of today -- credit default swaps. What's going to be the tool of tomorrow that someone else uses?

And so what I want to know is that this administration, which I'm so excited about, and I love the fact that you just said the president of the United States, and I know the president of the United States in this new capacity is going to do great things, but I want to know that this larger issue of the financial markets being out of control and the fact that they can create exotic tools faster than we can regulate them is a tremendous problem for our economy.

And I want to understand how we're going to fix that and not wait for the next tool to come along.

GEITHNER: I completely agree with you. I think you're -- you said it very well, which is that innovation got ahead of risk management and restraint and prudence. It's -- it's always the case. It's too slow to catch up.

A critical objective -- I know the president believes and is deeply -- is try to make sure that our system is designed with a set of rules to make that less likely in the future.

CANTWELL: So -- so how are you going to do that? What -- so...

GEITHNER: We're going to...

CANTWELL: I think Professor Stigletz or somebody said, well, have every new tool come through a clearinghouse before it's implemented.

So I -- I'm just suggesting that is one idea that's been thrown out, but how do you approve the before they get into action, because the $62 trillion credit default swap market that blew up this whole thing is definitely not the way to go.

GEITHNER: Well, Senator, we will be open to any suggestion we think will work. We'll consult very careful in widely. And we're going to -- I know the president wants to come to the Congress quite quickly and day out a framework of recommendations for reforms.

And if you confirm me for this job, I will play a central role working with my colleagues in the SEC, the Fed, all the bank supervisors, the accounting profession, et cetera, so we can meet the basic objective you laid out to make sure that innovation and the future does not get so far out in front of the checks and balances in the system that we're left with this level of risk and fragility of the system.

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

Thank you, Mr. Chairman.

BAUCUS: Thank you, Senator. I think that's a very important question. It's not just in the financial markets. It's also loopholes in the tax code.

You know very bright tax attorneys can figure out ways to get around the tax code way too quickly, and it's very hard for the IRS to keep up the tax -- I think in many respects the IRS has not kept up.

So that's another area where you're going to have to try to think about how we don't get too far behind -- in fact, how we not get behind, as industry has developed fancy exotic instruments to -- to make a buck for themselves at the expense of -- of the rest of America.
I -- and I'm a little concerned with your answer. I understand that -- I understand on the surface your answer that it's -- well, these things are incredibly, enormously complicated, you want to do us right on that. I understand all that. A slight concern I have is that -- that, again, very bright people in these institutions and their lawyers are going to come to you with all these fancy ways of doing all these things, and -- and more often than not, it creates a lot of stuff that -- that really does not help the American economy.

There are many who think that we spend much too much time in America developing the exotic financial products at the expense of, say, the manufacturing sector, at the expense of the real economy, and investors who buy this go to Wall Street -- they don't go to engineering schools -- and to develop better products.

And I -- and so I'm concerned that -- I'm hopeful that you're very, very -- maybe "tough" is the word -- in coming up with some -- a new regulatory regime, and I think it's then a terrific signal that we're not going to indulge a lot of the exotic new stuff which is not really very productive at all in the real sense of the term, but, rather, we'll move more towards the real economy where we can start making things and doing things to help strengthen our economy overall.

I have another question for you, and that's the -- China. I think the -- how we manage our relationship -- the United States with China -- is going to -- it's extremely important, in some ways determinative of the -- the living standards of Americans as well as Chinese and, for that matter, people in other parts of the world.

I applaud Secretary Paulson's efforts to set up this strategic economic dialogue. I think that helped. That didn't -- it wasn't the be-all end-all, and, in fact, Secretary Paulson said -- not too long ago, I read, you know, that even though that did help a lot, he's somewhat convinced now that nothing ever happens unless there's a crisis. Now you can talk to death, but nothing really happens unless there's a crisis.

So I'm -- our charge -- our American charge to the next administration is to figure out ways to avoid a crisis, but get -- do what needs to be done to avoid a crisis. We can talk about that in the financial sector. You yourself said that you saw this coming, the storm clouds coming in 2007, early 2007. Yet, for some strange reason, we -- this country did not respond to those storm clouds. Now maybe people didn't listen to you enough, maybe you were not sufficiently forceful, I don't know, but, nevertheless, we -- it just -- in this turbulent volve (ph) of globalization times we all face, it's -- it's an -- early warning systems are going to be even more important than before, and having the intestinal fortitude and the courage to follow it up is going to be even more important than -- than it has been in the past.

And so with respect to China, I just urge you -- I'd like your response to how we get to the point where the RMB -- the yuan is a market of currency, it's not set by the Chinese government as it now is, and how we get off this mutual addiction -- American consumers addicted to Chinese products and China addicted to loaning to us.

Your thoughts?

GEITHNER: Senator, I -- I like to start always in this case by emphasizing the obligation we have to put in place a set of policies that are going to improve confidence in Americans and investors around the world in our capacity to run our country more effectively, not just to make our economy more productive in the future, but to try to convince people we will be able to live within our means and put our fiscal position on to a more sustainable path and to confront the very -- very difficult long-term question of entitlement that we've had such a hard time coming to grips with in the future. I think that's absolutely central. We can be careful, creative, effective in our relations with other countries, and unless we do that well, those efforts, diplomatic and others, will not be effective in protecting our interests as a country.

I completely share any deeply believe your central point about China's importance to the global economy and to our -- our economic and financial future, and I think we have to get that right. Our interests as a nation lie in trying to make sure China manages this transition as effectively as possible with least potential damage or risk to this -- the global economy, and it's going to require a very substantial sustained engagement of attention and time.

I -- in my time at the Treasury in the past, I was part of a lot of efforts, some which were not very effective, some which were very effective, in trying to -- designing fora with China and other countries that will help make sure we can work on things together which meet our mutual benefit, and I will -- if I'm confirmed, I will play a very active role in that-- in that effort.

The -- I'll repeat on the exchange rate front, on the exchange rate fund to -- which is, again, just -- just to say that I believe that it's in the interests of the global economy, not just our interests, that our major trading partners move over time to a more flexible exchange rate system, and that will be an important, difficult challenge I will face, is to try to figure out how best to advance that objective, not just with China, but with our other major trading partners as well.
BAUCUS: It's going to take a humungous effort. I just hear again Secretary Paulson's words that nothing much happens, just a lot of talk, unless there's a crisis, and it's just going to take a huge effort on your part and the parts of others to do what needs to be done to divert that crisis.

I've heard you a couple of times refer to entitlements. I'm curious what you mean by that. I'm a little concerned it's kind of a throwaway by the administration. It's going to -- various people are concerned about entitlements, and the easy thing to say -- some people -- "Gee, it's entitlements. That's the problem."

And I'm concerned -- I'm just curious what your thoughts on that subject are because, as you well know, the Social Security trust fund's in not bad shape, and I think the projections I saw -- it's not -- it's not going to go belly up for another 20 years maybe. If -- that's not a huge part of the problem.

(UNKNOWN): 2041.

BAUCUS: Sorry?

(UNKNOWN): 2041.

BAUCUS: 2041. We have a few years between now and 2041. That's not urgent today.

And second, with respect to the Medicare trust fund, which is more urgent, the -- it's the temptation to say, "OK. We're going to cut entitlements," and I say "temptation" because the main reason health care -- the main reason that the Medicare trust fund is rising at such an alarming, rapid rate is not because of baby boomers. The Congressional Budget Office did a study a couple of months ago and showed that's a very small part of the problem.

The main reason is because health care costs in this country are rising at such a rapid rate, not just for Medicare, but for the entire country. We spend $2.3 trillion a year on health care in this country. You know, it's about roughly half-half public-private, and so the real reason answer in entitlements reform is not entitlement cuts. That's not the answer, and I think it's -- it's -- we should stop saying it that way. It raises incorrect expectations.

The real answer is really health care reform, and it's getting a handle on the rapid rise and increase in health care costs. As you know better than most anybody, we spend about twice as much per capita on health care than does the next most expensive country, and we -- our results are about -- we're ranked in America about 17th or 18th or 19th worldwide in health care condition. So we're not getting our money's worth here. So I -- and it's going to be hard.

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

GEITHNER: I agree, and I accept that advice, and I think you're right that you can't get the Medicare -- you can't get to the broader solvency problems in Medicare without getting there through health care reform that effectively addresses the rising costs. I think that's absolutely right.

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

BAUCUS: I appreciate that, but Social Security is a quite small part of the long-running problem.

GEITHNER: Yeah, it's a much...

(CROSSTALK)

GEITHNER: It's a much smaller challenge.

BAUCUS: The $1.1 trillion -- CBO has -- has nothing to do with Social Security, very little to do with Social Security.

GEITHNER: Yes.
BAUCUS: -- nothing to do with Social Security because we're borrowing from it, but it really had to do with all the other problems that -- loaning, this TARP, and everything under the sun. That's -- that's the reason. It's not...

GEITHNER: Completely agree.

BAUCUS: ... and so one shouldn't say, "Oh, the problem is Social Security."

GEITHNER: No, no. I didn't mean to imply that. I just meant to say that this basic challenge of credibility on the fiscal side is an enormously consequential and important challenge, and it requires health care reform, I completely agree, but that's necessarily not sufficient, and we need to make sure that, again, as we move forward, we do a better job of earning the confidence of the American people that we're going to be able to confront these things. BAUCUS: Thank you.

Senator Grassley?

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

But I want to move on beyond that to discuss with you what I consider a lack of transparency with the level of public disclosure about the assets being held by the Federal Reserve through Maiden Lane, LLC. Specifically, it appears that the reported valuation of those assets may be overstated. The reason is that much of the debt in the portfolio is guaranteed by Freddie Mac and Fannie May, which are in turn guaranteed by the federal government. In other words, a rosy scenario for Maiden Lane, LLC, is not necessarily a rosy scenario for taxpayers.

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

GEITHNER: Senator, what I like to emphasize is that we put in place, after we did that enormously consequential decision last March, a regime where on a quarterly basis we disclose publicly an estimate of valuation that is produced by a very carefully designed process to make sure it's independent and careful so that we're providing, again, the best judgment of what the value is in that context, and that's very important to me, and I think it's very important to the Fed, and I -- and I respect and appreciate your concern that we achieve that.

We believe it is designed in a way that's very careful with a good set of checks and balances there, and -- and I think it will -- I think that regime will stand the test of time. But on a quarterly basis, the American people will see what that estimate is, how it's changing over time and, therefore, they'll see one measure, not a complete measure necessarily, but one measure of the risk to the American taxpayer in that judgment.

But just before I conclude, you need to judge that against the benefits we achieved in preventing default at an enormously fragile moment in our country of a major systemic financial institution.

GRASSLEY: What would be the situation if those assets were not guaranteed by the federal government?

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

GRASSLEY: OK. Given that Bear Stearns and AIG bailouts were conducted outside of TARP, do you think that it makes sense to broaden the authority of the special inspector general for the TARP to oversee these funds as well, and if you don't agree with me, why not?

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

GRASSLEY: Well, thank you.

You said in your statement today that you intend to reform the TARP to, quote, "ensure that there is enough credit available to support recovery," end of quote, and "additional," quote, "with," quote, "tough conditions to
protect the taxpayers," end of quote, and "to ensure transparency," end of quote. How do you intend to reform the program, and how do you intend to increase transparency? Do you agree with Secretary Paulson that the focus of the program must return to troubled assets rather than bailing out banks?

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

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

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

Larry Summers laid out a number of specific suggestions in the last two letters last two weeks about how best to do that. We're open to any other suggestions on how to do that.

And if I'm confirmed, a critical priority of the secretary of the treasury will be to try to be responsive to those concerns you and so many others have expressed about how the program has been implemented.

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

GRASSLEY: Mr. Chairman, you took nine minutes. could I have four more minutes?

BAUCUS: Clearly.

GRASSLEY: OK.

Regarding the three special purpose vehicles involved with J.P. Morgan which absorbed Bear Stearns and AIG, when will financial statements of these entities be made public? Doesn't the use of these -- that's one.

Does the -- doesn't the private -- doesn't the use of these private vehicles result in less transparency since J.P. Morgan and AIG may otherwise have had to report such investments to the SEC reporting?

And do you think that these entities should be subject to SEC reporting requirements? Why or why not? So it's three questions.

GEITHNER: Senator, important questions. I think that the regime put in place around disclosure and the accounting standards applied to those entities are -- are very strong.

And I believe that the checks and balances in place, again, provide a very effective set of provisions. And they were designed in a way to meet generally accepted accounting principles, again, with a disclosure regime that's consistent with what we'd apply generally to financial institutions.

But as always, I'm a practical person, and if there are ways we can improve on that record, I would be open to doing so, working with my colleagues at the Fed.

GRASSLEY: OK. So then you're -- you're saying -- I think you're disagreeing with me, and maybe my impression of it's wrong, but I think there's less transparency. But you're saying they -- there isn't. Is that what you're saying?

GEITHNER: I believe...

GRASSLEY: Because we'll -- we'll have to sit down and talk about that, then.

GEITHNER: Again, I think what -- I think what has to go into this is a -- is a range of different things. One is you want to make sure that there's a carefully designed regime for...

GRASSLEY: Yeah.
GEITHNER: ... setting the value in these things, and that the accounting regime that applies and the
disclosure requirements that apply meet the important objectives you laid out.

And we believe this framework meets those objectives. But as I said, I'm a practical person, happy to listen
to suggestions on how to improve that.

GRASSLEY: OK. Why is it that BlackRock is the only firm qualified to value and manage the assets of
special purpose vehicles?

Did you consider any other firms? And if yes, why was BlackRock selected? And if no, why were others not
considered?

GEITHNER: Well, in the -- let me just address the Bear Stearns case in particular, because that's initially
where we asked BlackRock to come provide this very important service.

You know, as -- as -- as you -- as I testified before, we had to move very, very quickly in that time frame, and
we believed at that moment we had no alternative.

They come with a world-class reputation and set of expertise in doing that, and we thought the interest of the
American taxpayer would be best served by having them there on our side as we made those consequential
judgments.

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

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

If that is the case, I do not understand why a federal bailout was necessary. Isn't it true that the only reason
that these assets, including mortgage-backed securities and collateralized debt obligations, have value is
because of the federal government guarantee?

If no, do you think the predominance of subprime mortgages was overstated and that the frequency of
defaults was overstated?

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

To help address that problem, the government of the United States and the Federal Reserve have done
extraordinary things. And those things have involved risk to the taxpayer. And we had to judge those risks
against the benefits we achieved for the economy of avoiding defaults with catastrophic consequences.

But you're right to -- to emphasize the fact that there were risks in the judgments we made. We try to
carefully control those risks, to make sure we understand them carefully and that there's good checks and
balances for how these are managed going forward.

But we have to judge that risk against the benefits we created for the economy and the financial system of
preventing default with catastrophic consequences.

GRASSLEY: Let me make a statement instead of asking a question. Assuming you're right, and they have
value, then shouldn't we be pointing the fingers at the big -- well, I -- I better say it this way.

I think we ought to be pointing the fingers at the three big credit agency -- rating agencies for downgrading
credit ratings of the securities.

GEITHNER: Well...

GRASSLEY: That's the way I see it.
GEITHNER: Well, I -- I agree with you that the rating judgments by the credit rating agencies have been -- well, how could I say it more starkly than what you did? Systematic failures in judgment about the level of the risks in the securities they were rating, and that played an important role in contributing to this crisis.

GRASSLEY: OK.

Thank you, Mr. Chairman.

BAUCUS: Senator Kyl?

KYL: Thank you, Mr. Chairman.

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

GEITHNER: Absolutely.

KYL: Questions relating to the value of the dollar, some questions relating to corporate finance. And in particular, here are the incentives and disincentives regarding debt versus equity financing, which are important to a lot of the things we've been talking about.

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

So I'll -- I'll give you a general question, and then on a program by program basis I'd like to have you answer that, because I -- I remember that you're going to be judged in a year or two, and this isn't or shouldn't be a political exercise. It should be what works, as President Obama said in his remarks yesterday -- what works.

And I understand that there are political reasons to support a lot of programs, but your job and what you said here is to evaluate whether they actually work to stimulate the economy to provide jobs and investment. And I think that you will be judged on -- on how you answer those questions.

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

But another area that there seemed to be great interest in -- and I'll just formulate a question for the record -- relates to your work in supporting Secretary Paulson on -- or working with him on the decision relating to Citibank both with respect to the acquire of Wachovia and the position you took on that when Wells Fargo came into the picture, as well as the judgments that you and others made regarding what Citibank needed and what it would need.

I mean, it turns out that Citibank is in worse shape than I think you all anticipated at the time.

But in order to try to give you a full opportunity to respond to some of the things that people are asking -- let -- let me state this predicate. One of the arguments for your being nominated is that you have been there.

You know the TARP program. You have been working with these things, that you're very intelligent, that you have good judgment, that you take your obligations seriously.

And given all of that, which I'll stipulate to, it seems implausible that, in effect, your only answer to the income tax issues that arose is that you have no answer, that you don't know why the mistakes were made, but they were made.

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

GEITHNER: I don't have the -- I can't see that form, but I believe that form is an annual -- annual form, but, Senator, as I said initially in response to Chairman Baucus' question, I had forms I received on a quarterly
You could say every payroll statement I got would -- gave me an opportunity to realize this mistake earlier. And the initial documentation the IMF gave me as a new employee laid this out clearly.

And when I went through that, in providing those forms in the committee, it was very clear that this was an avoidable mistake. It should have been avoided.

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

You're right. I had many opportunities to see it. But having missed it initially, I kept missing it.

KYL: Well, thank you for that. That wasn't really the point I was trying to make. What -- what a lot of my constituents have said is obviously, there is no defense that I just missed it when you're audited by IRS.

And in fact, most people, even if they have a relatively small obligation, pay a penalty on that. And that -- that's another issue about why, in effect, somebody in your position received what could be considered as preferential treatment without having to be penalized. In fact, at least two or three of my constituents said would I support a safe harbor of anything under $35,000, you don't have to pay penalties. I said well, I'll be happy to ask Mr. Geithner if he would support that. I rather doubt it.

GEITHNER: Senator, could I respond just on that...

KYL: Sure, absolutely.

(CROSSTALK)

GEITHNER: When the IRS conducted its audit and told me what I owed, their initial assessment included an assessment of penalties. But at that point, they explained to me -- and I paid those penalties initially, as you would expect me to do.

But at that point, they explained to me that this -- they have found this to be a -- they used the word, I think, common problem and they encouraged me to apply for a waiver of my penalties, and they subsequently granted that -- that -- but that was a judgment they made.

And -- and that just goes to the point, I think, that they felt this was a common enough problem, that it wasn't unusual in my circumstance.

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

KYL: I'm sure that when you sign documents you try to be careful about what you sign, and that you at least read some of what you're signing.

This is what strikes me as somewhat implausible. When you're given a piece of paper to sign, and -- I mean, you'd at least look at the title, I would presume, and the title says "Tax Allowance Application for U.S. Federal, State Income Taxes and Social Security Tax."

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

Do you remember ever reading that? GEITHNER: Senator, as I said, when I went back and read that when providing it to the committee, it was very clear, and I should have read it more carefully.

But again, I thought I was complying at that point, had no indication, no knowledge, that I wasn't. That's why I signed it. And having done it that first time, I systematically signed it going forward. I should have been much more careful.

And you -- you're -- and -- but I agree -- I understand your concern with that, and as I said, there was ample opportunity in what the IMF provided me that I could have caught this earlier.
KYL: Now, my understanding is that you -- I don't know if you sat right down and wrote the checks, but soon after knowing what your liability was -- or, excuse me, what the tax allowance was for the federal and state taxes, you sat down and wrote those checks.

And on -- is that correct? I think that's what you told us.

GEITHNER: Yeah, every quarter, I wrote a check which I believed covered my tax liability as an American citizen. And -- but of course, I was mistaken in that.

And because that initial year when I did my full returns I did not catch that mistake, I -- I continued it. And -- and as I said, although I think maybe you were out of the room when I said this, that because in subsequent years my -- when my returns were prepared by an accountant, they didn't catch it, I was left with the mistaken belief that I fully complied.

KYL: Yeah. On the reverse side of the application, there are three lines right in a row -- federal tax, state tax, S.E., meaning self-employment tax.

What explanation do you have for writing the check for federal and writing the check for state, and somehow totally ignoring the very next line?

GEITHNER: Again, you're absolutely right that every quarter I received a form with those lines on it. In fact, if I go back, I think that maybe even every payroll statement lays it out that way. But again, because that first year -- remember, I always thought I was an employee of the IMF. I didn't -- I was not self-employed by the IMF; I was an employee of the IMF.

So I did my tax -- and my income was reported on a W-2. So I did my taxes the way I'd always done them when I had W-2s and treated that as employee income. And because of that and the way I did my returns, I didn't catch it early enough.

But you're absolutely right, Senator. I am ample opportunity in each of the forms -- and I provided these forms to the committee -- to catch this earlier.

KYL: You know that were doing something by signing this; that you were applying for something. What did you think you were doing when you first signed this?

GEITHNER: I thought I was certifying that I'd met my obligations, which I thought I had.

KYL: You didn't even appreciate that you were applying for what they euphemistically call a gross-up in your salary in order to offset the tax liability?

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

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

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

GEITHNER: I do not know, Senator. But I believe I gave the committee and, of course, the presidential transition team all the documents relevant to that audit. KYL: Would you double-check and make sure?

GEITHNER: I will.

KYL: There's a reason for my question and I will follow it up with the second question.

In discussing this with your auditor -- I mean, it had to go something like the following. So I owe some additional taxes? Yes. What for? Well, supposed to pay this self-employment tax which you didn't pay.

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

GEITHNER: Absolutely.

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

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

KYL: I understand that, but I’m asking about your state of mind when you first became aware of the fact that you had an additional liability as a result of this audit and you found out why you had that additional liability.

It's strange credulity to think that it didn't immediately occur to you that you had that liability for the whole time that you were at IMF.

GEITHNER: Senator, as I said, if I thought about it more at the time, I would have asked a lot more questions. I would have handled it differently and I regret not having done so. This is my mistake, and it's my responsibility.

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

Here's the question that, at least, a couple of constituents wanted an answer to. And it is a perfectly legitimate answer if you answer the question yes. But you've said otherwise.

Isn't it a fact that you immediately or very quickly realized that the same mistake that was made in 2003 and 2004 was probably made for 2001 and 2002 but that the statute of limitations had run and you didn't have to pay the tax for those other two years? The auditor said you didn't have to pay anything more than for 2003 and 2004. And you accepted that and, I think so, 99 percent of taxpayers would say, well, I'm glad the statute of limitations ran and I didn't have to go back and pay the other two years.

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

GEITHNER: Senator, as you said, an IRS audit is an extremely serious thing. I took it very seriously. I looked very carefully at what they said I owed. I paid what they said I owed. And as I said to you many times, when I think back on it now, I should have asked a lot more questions. I should have taken more care in considering (inaudible) the time.

But when the IRS conducts an audit and they tell you that this settles your obligations, I paid what they said I owed.

KYL: Sure. And any taxpayer would. But my question to you is a little different from that. And that is whether you thought at the time or at any time thereafter, you know, I didn't do anything different those first two years, I probably would have owe that did, too, except that the statute of limitations has run so I don't have to pay that.

Did that thought never cross your mind until you became a candidate for nomination as secretary of the treasury?

GEITHNER: Senator, again, as I said, the IRS told me what my obligations were. I met though obligations. And I did not think about it again until, as going through the vetting process and I disclosed all this material to those committees. They came and asked me a bunch more questions about that. And it was in that context that I decided that it was appropriate at that point to go back and correct for that early error.

And as I said to you before, I regret having not done that sooner. I believe I should have done it sooner. And if I'd thought about it more, maybe I would have come to that judgment sooner.

KYL: But you're saying that is the first time that it occurred to you that you also could have a liability for 2001 and 2002?
GEITHNER: That was the first time I thought so carefully the question about whether I should go back and cover that. And -- but, again, I should have thought it more carefully before. And if I think about it today, I would have handled that differently.

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

And, again I'll say it's legal to rely on the statute of limitations. There's nothing wrong with relying on the statute of limitations. I think what some people find implausible is that that isn't what you're saying you did. What you're saying is that you didn't think about it until it was brought to your attention in connection with your nomination. Is that correct?

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

KYL: But that's different from the question I just answered. You are not now then saying that it didn't occur to you prior to the -- to your nomination that you might also have an obligation for 2001 and 2002 which is barred by the statute of limitations. Is that correct?

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

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

GEITHNER: Senator, I did not believe when I settled that audit and paid what they (sic) owed me that I had obligations to go back. I did not think about that until I was going through the vetting process and had disclosed at that point to the transition members reviewing my tax records the entire circumstances surrounding that episode. I had not thought about it in the intervening years. No occasion to think about it.

And I might not have thought about it unless I had gone through that process. But having thought about it then, I did what I thought was right, which was to go back and correct for that error.

KYL: OK. That's a relatively clear answer. The answer being no, you didn't think about it until it became important in connection with your nomination.

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

KYL: Yes. And that's the first time it occurred to you that it may be that you avoided the liability because of the statute of limitations. GEITHNER: I did not believe, Senator, that I was avoiding by liability. Senator, I have worked in public service all my life. My first job in government was as an employee of the Treasury. I grew up in government with a deep appreciation of the obligations that come with that. I would never put myself in the position where I was not -- where I was intentionally not meeting my obligations as an American taxpayer.

In this case, I made a series of mistakes, but they were not intention mistakes. They're my responsibility. I take those things extremely seriously. And, again, I regret those mistakes, but they were not intentional. I've corrected them. But they're my responsibility.

KYL: OK. Rather than me asking for any additional testimony, review carefully what you said and if you think it needs to be modified in any -- because you're under oath here. If it needs to be modified in any way, please provide that for the record.

BAUCUS (?): OK. Thank you, Senator.

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

As is our usual practice, the senators will have written questions for you and submit those to you. And I ask that all senators submit those questions by 5 o'clock this evening.
And I urge you, Mr. Geithner, to respond to those questions before our markup of your nomination tomorrow morning at 10 o'clock.

GEITHNER: OK. Thank you, Senator.

BAUCUS (?): The hearing is adjourned.

END