SENATE BANKING COMMITTEE

"CARES ACT OVERSIGHT OF THE TREASURY AND FEDERAL RESERVE: SUPPORTING AN EQUITABLE PANDEMIC RECOVERY"

September 28, 2021 – 10:00 AM

OVERVIEW

On Tuesday, September 28, the Senate Banking Committee held a hearing titled, "CARES Act Oversight of the Treasury and Federal Reserve: Supporting an Equitable Pandemic Recovery." During the hearing, Senators and witnesses discussed: the debt ceiling; continued economic support, the child tax credit; inflation; a central bank digital currency (CBDC); the Organisation for Economic Co-Operation and Development (OECD); stepped-up basis; increased reporting to the Internal Revenue Service (IRS); Fed regulatory supervision; the supplementary leverage ratio (SLR); deficit spending; budget reconciliation; energy financing; systemic risks to the financial system; and Fed presidents securities trading controversy.

OPENING STATEMENTS

- Chairman Sherrod Brown (D-OH)
- Ranking Member Pat Toomey (R-PA)

WITNESS PANEL

- The Honorable Janet Yellen, Secretary, Department of the Treasury
- The Honorable Jerome Powell, Chairman, Board of Governors of the Federal Reserve System

QUESTION AND ANSWER SUMMARY

Debt Ceiling

Chairman Sherrod Brown (D-OH) asked Secretary Yellen about the consequences of not raising the debt ceiling. Secretary Yellen responded there would be "catastrophic economic consequences," as it would "cause the government to default on its obligations." She asserted failing to raise the debt ceiling would be "disastrous for the economy, global financial markets, and millions of families and workers whose financial security would be jeopardized by delayed payments." Specifically, she stated 50 million senior citizens could potentially stop receiving or have delayed social security payments, 30 million child tax credit recipients would not receive their payments on time, and payments to servicemembers could be delayed. She concluded that "even coming really close to the debt line can undermine the confidence of financial markets in the credit worthiness of the U.S.," adding this could "lead to a debt downgrade and soaring interest rates which raise payments to mortgages, auto loans, and credit cards."

Senator Jon Tester (D-MT) asked Secretary Yellen if the debt ceiling must be raised to pay previous debts, not to authorize additional deficit spending. Secretary Yellen answered in the affirmative, adding raising the debt ceiling "has nothing to do with future programs." She argued raising the debt ceiling is "about paying bills already incurred by this Congress and previous Congresses."

Senator Mark Warner (D-VA) asserted that defaulting on the federal government's debts would result in an increase in the interest rate, subsequently adding more than $200 billion a year in additional, mandatory interest payment spending. He then asked Secretary Yellen if this calculation is correct. Secretary Yellen answered in the affirmative and suggested "there is no question that if Congress were to fail to raise the debt limit, or even if it was feared that we are getting close, that you would expect to see an interest rate spike." She expressed concern that defaulting on these debts would undermine the confidence in the dollar as the world's reserve currency. Senator Warner then asked if this potential increase in interest payments could be reversed through congressional action. Secretary Yellen answered in the negative. She stated, "this would be a manufactured crisis we would impose on this country that is already going through a very difficult period." Senator Warner asked if this default would undermine the confidence in the dollar and in turn "give more credibility" to China's effort to make the RMB the world's default currency. Secretary Yellen agreed failing to raise the debt ceiling would "undermine confidence in our government and in the role of the dollar," but she argued "China has a long way to go in reforming its financial markets before the RMB is a serious rival to the dollar."

Senator John Kennedy (R-LA) asked if Democrats in Congress can raise the debt ceiling without Republican support. Secretary Yellen responded "it is important to recognize that raising the debt ceiling is a shared responsibility" of both parties. She added that "deficits have been run under both Democratic and Republican administrations and it is important to recognize that."

Continued Economic Support

Chairman Brown asked Chair Powell why the Federal Reserve ("Fed") is "tak[ing] away economic support" even as "the recovery failed to reach so many Black workers." Chair Powell responded the Fed is currently purchasing $120 billion worth of securities every month, and it has a plan to taper these purchases once it has reached "substantial further progress towards our statutory goals." He stated the Fed has not yet met its goals, but it is on the path to do so. He concluded the Fed will "continue to add accommodations until well into the middle of next year."

Child Tax Credit

Chairman Brown asked how an expansion of a fully refundable child tax credit can increase labor force participation rates and "boost local economies." Secretary Yellen responded, "evidence shows very strongly that [the child tax credit] helps parents take care of their children." She explained this credit is used to pay for basic needs of raising children, such as childcare which allows parents to have increased participation in the workforce.

Inflation

Ranking Member Pat Toomey (R-PA) asked Chair Powell if the current inflation rate is indicative of "broader and more structural" inflation risks. Chair Powell responded "it is fair to say that it is." He highlighted worsening supply side restriction and noted "we need the supply blockages to abate before inflation can come down." He added the current inflation is "still from a very small category of items."

Senator Richard Shelby (R-AL) asked Chair Powell if there is a "strengthening" between unemployment and inflation. Chair Powell claimed "there is a relatively modest relationship" between unemployment and inflation, and the Fed does not expect this to change in the near term.

Central Bank Digital Currency (CBDC)

Ranking Member Toomey stated he is "increasingly intrigued" by the opportunities a central bank digital currency (CBDC) can provide the U.S., specifically: instant, zero-cost payments; interoperability and programmability with smart contracts; and international competitiveness. However, he expressed concerns about how to structure a CBDC to ensure privacy and interoperability with private sector digital currencies. He then asked Chair Powell if congressional approval is necessary for the Fed to develop a CBDC. Chair Powell stated "it is possible a CBDC could be authorized under current law," but he advocated for "broad consultation and authorizing legislation from Congress."

Organisation for Economic Co-Operation and Development (OECD)

Ranking Member Toomey highlighted that Pillar 1 under the Organisation for Economic Co-Operation and Development (OECD) negotiations would "rewrite how profits are allocated among countries and cede U.S. taxing rights to other jurisdictions." He then asked Secretary Yellen if implementation of Pillar 1 requires Senate approval. Secretary Yellen acknowledged there is "a number of ways" in which Congress could implement Pillar 1, but "certainly ratification of a treaty is one way Congress could authorize it." She added that "certainly" Congress must authorize the transfer of taxing rights contemplated in Pillar 1.

Stepped-Up Basis

Senator Shelby noted the American Families Plan proposes an elimination of stepped-up basis, and he argued this change "would result in a costly tax increase on family-owned businesses." He then asked Secretary Yellen if she supports eliminating stepped-up basis for estate beneficiaries. Secretary Yellen answered in the affirmative because "a very large share of the income of wealthy individuals is simply never taxed." She asserted that the "wealthiest individuals pay very low taxes overall because much of their income is unrealized capital gains." She explained the Biden Administration has proposed taxing those gains at death or taxing gains when the asset is sold, while maintaining "careful consideration not in any way to harm the prospects of family-owned farms or small businesses." She concluded that she regards stepped-up basis "as a kind of loophole that allows a large portion of income of the wealthiest individuals to go untaxed."

Increased Reporting to the Internal Revenue Service (IRS)

Senator Cynthia Lummis (R-WY) expressed concern with Treasury's proposal to require banks and credit unions to report customer data to the Internal Revenue Service (IRS) for any transaction of $600 or more. She then asked Secretary Yellen if this is an "unnecessary" regulatory burden. Secretary Yellen stated she disagreed with Senator Lummis' assessment and argued Senator Lummis "misunderstands the proposal." She explained banks already report customer information to the IRS, and the proposal does not require detailed transaction level data reporting; rather, it adds two additional reporting requirements on the aggregate inflows and outflows of an account for the year. She highlighted the estimated $7 trillion tax gap over the next decade that can be partially addressed through increasing tax compliance.
Senator Bill Hagerty (R-TN) also noted the proposed requirement to report transactions above $600 to the IRS, and he expressed concern about the ability of the IRS to protect individual's data. Secretary Yellen asserted "protecting taxpayer information is the highest priority of the IRS." She acknowledged the ProPublica tax leak and stated, "we do not know the ProPublica information came from the IRS." She added the Biden Administration is proposing increased investments in the IRS to modernize its system and establish "better controls to protect taxpayer information."

Fed Regulatory Supervision

Senator Elizabeth Warren (D-MA) asserted the Fed "weakened" its stress test requirements. She argued without federal support, banks would have lost up to $300 billion during the COVID-19 pandemic. Chair Powell alleged the Fed has not weakened stress test requirements, and banks that fail the stress test have their distributions limited. He claimed banks would have been able to absorb the projected $300 billion in losses "without difficulty."

Senator Warren then stated, in 2020, the Fed removed Volcker Rule restrictions on whether banks could cosponsor family funds. She noted that earlier this year, the collapse of Archegos caused banks to lose $10 billion. She then asked Chair Powell, given the Archegos event, if should the Fed have changed Volcker Rule restrictions. Chair Powell responded Archegos was a family office, so he "does not know if there are any Volcker Rule implications" for this particular case. However, he stated generally it was "widely agreed that the Volcker Rule as implemented was complicated and not workable."

Senator Warren asked Chair Powell about the Fed lowering liquidity requirements by 15 percent for banks with $250 billion to $700 billion in assets. Chair Powell asserted there has not be any evidence "that this was a bad idea but we can look at it again."

Supplementary Leverage Ratio (SLR)

Senator Mike Rounds (R-SD) highlighted that the Fed provided a supplementary leverage ratio (SLR) exclusion for ultra-safe assets from banks' balance sheets during the pandemic. He then asked Chair Powell if the Fed would consider continuing this exclusion. Chair Powell noted this exclusion "worked during the crisis," and the Fed does not "want leverage ratios to be the binding constraint on banks." He explained the Fed needs to be "very careful" with the SLR because "we need to ensure changes we make to it will not reduce the overall bindingness of the capital requirements for the largest institutions." He added the Fed is currently examining modifying the SLR because "with all the liquidity in the system, it could again become the binding constraint that would not be good from a safety and soundness standpoint."

Deficit Spending

Senator Daines asked Secretary Yellen when "enough is enough when it comes to [U.S.] deficit and debt." Secretary Yellen explained there are a "number of different metrics" used to calculate a reasonable level of debt. She claimed a "better measure of fiscal sustainability" is calculating the real net interest costs of the debt, which has been negative for the last several years for U.S. debt payments.

Budget Reconciliation

Senator Tim Scott (R-SC) asked how lawmakers can support the $3.5 trillion reconciliation package given "spiking inflation, slow economic growth, and high unemployment." Secretary Yellen responded the budget reconciliation package will be "paid for through increases in taxation on corporations and high-income individuals." Senator Scott asked Secretary Yellen if increasing the capital gains tax to 43.8 percent and corporate tax rate to 28 percent "will lead to more opportunity." Secretary Yellen responded the budget reconciliation package's impact on investment spending will likely be "very small." She argued the 2017 Tax Cuts and Jobs Act (TCJA) did not result in a "surge in investment spending" when the corporate tax rate was lowered, claiming that the "linkage between investment spending and the corporate tax rate is very modest." She concluded the Build Back Better package will "improve corporate competitiveness because it will invest in critical infrastructure in the economy."

Senator Hagerty stated Senate Majority Leader Chuck Schumer (D-NY), Speaker Nancy Pelosi (D-CA), and Secretary Yellen announced they reached an agreement on a framework to pay for the budget reconciliation package. He then asked Secretary Yellen what is included in this framework. Secretary Yellen responded the framework includes "a list of ideas where there is support from the House, Senate, and White House on how revenue could be raised that would be sufficient to cover the expense of programs under consideration." Specifically, she stated it includes increasing the corporate tax rate; reforming international provisions that will "reduce incentives in the tax code to export jobs and profits to lower tax areas;" increasing taxes on high-income individuals making "well above $400,000;" increasing the tax rate on capital gains; and improving tax compliance. Senator Hagerty then asked if Secretary Yellen could provide him details of the framework. Secretary Yellen responded in the negative citing ongoing negotiations. She highlighted the specific proposals in Treasury's Green Book and the House Ways and Means markup of the bill pertaining to revenue raisers.

Energy Financing

Senator Steve Daines (R-MT) stated the transition in Europe and the United Kingdom (UK) to renewable energy has led to increased energy prices. He then asked Secretary Yellen if the proposed tax increases on the fossil fuel industry will lead to energy price increases similar to Europe and the UK. Secretary Yellen stated President Biden's proposed plan would "shift entirely the electricity sector reliance to renewable" by 2035. She acknowledged the concerns surrounding reliability of renewable energy, such as solar and wind power, and stated there is energy storage technology that can be deployed alongside renewable energy sources.

Systemic Risks to the Financial System

Senator Jon Ossoff (D-GA) asked about the biggest systemic risk – beyond COVID-19 – facing the U.S. and global financial systems. Chair Powell expressed concern about cybersecurity risks, noting "we have not faced the full brunt of a successful cyberattack on a financial institution" yet. He argued cybersecurity is a "high priority." Secretary Yellen expressed concerns with the growth of activity in the shadow banking sector, such as open-end bond funds and "massive withdrawals by individuals that can trigger fire sales of assets with systemic consequences." She stated the Financial Stability Oversight Counsel (FSOC) is examining these issues, including issues "relating to hedge funds and the possibility of leverage there that can trigger financial runs." She added that climate change is another area that poses "significant risk to the financial sector and economy."

Fed Presidents Securities Trading Controversy

Senator Raphael Warnock (D-GA) cited the recent controversy over regional Fed Presidents in Dallas and Boston trading their private investments while the Fed was intervening in the markets. He then asked Chair Powell what actions he has taken to ensure the impartiality of the Fed and what safeguards failed in these situations. Chair Powell stated he has directed staff to review internal investment and trading practices that "seem[ed] to have worked for a long time and are clearly not working now." He continued that the trades made by the regional Fed presidents were in compliance with the existing rules, so the Fed is in the process of creating recommendations to modify these practices.

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Please click here for the archived hearing.