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Acting Assistant Secretary for Financial Markets Karthik Ramanathan Testimony

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U.S. DEPARTMENT OF THE TREASURY

Press Center

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Before the House Small Business Committee

Washington - Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee, thank you for this opportunity to testify this morning on the recent financial market and economic conditions, Treasury's actions in implementing the Emergency Economic Stabilization Act (EESA), and how these actions will assist small businesses and entrepreneurs in leading the economic recovery in the United States.

Small businesses are crucial to the health of the U.S. economy – they provide the entrepreneurial talent that keeps the economy flexible and dynamic. Small businesses employ over half the workforce in the United States, and are estimated to generate seventy percent of all new jobs. Given the current economic challenges we are facing, I am pleased to be here to address this timely topic and to emphasize the importance of this sector for the growth of the American economy.

As the Acting Assistant Secretary for Financial Markets, I serve as the senior adviser to the Secretary, Deputy Secretary, and Under Secretary on broad matters related to domestic finance, financial markets, federal, state, and local finance, including the Federal debt, and Federal Government credit policies. My office is also responsible for the issuance of over $5 trillion in annual debt and for overseeing the $10 trillion U.S. Treasury debt portfolio.

As you know, the economy is currently working through a prolonged housing correction that began over two years ago, and has in turn impacted credit markets and financial institutions. The downturn in the housing market as well as financial and credit market pressures have negatively impacted the real economy. Small businesses and consumers have also felt these headwinds as employment, capital investment, and consumption have declined.

The financial challenges we currently face have been caused to a great degree by a decline in the value of mortgage assets and continuing uncertainty about their value in the future. The depreciation of these assets on highly levered bank balance sheets has resulted in an undercapitalized banking sector, and uncertainty surrounding the value of these assets makes banks reluctant to lend to one another, which in turn affects credit availability for consumers and businesses. Community banks, thrifts, and credit unions are vital components of the financial market, and ensuring their health helps to encourage the lending and borrowing activity that is critical for small businesses and consumers. Therefore, it is imperative that we, as policy-makers, promote a healthy financial sector as we confront these challenges.

As the housing correction progresses and home prices stabilize, the turmoil in the financial markets will also subside, allowing credit once again to flow more smoothly through the economy. In the meantime, to alleviate credit market strains, the Treasury, the Federal Reserve, and the FDIC, along with our international counterparts, have taken unprecedented and extraordinary steps to address the current financial crisis-- steps aimed at strengthening bank balance sheets, easing strains in interbank lending and short-term funding markets, and providing needed liquidity. Both U.S.-based and international bodies remain committed to restoring and enhancing the strength of the global financial architecture.

While the long-term economic prospects of the United States are solid, the United States – as well as the global economy – faces considerable near term challenges. The slowdown in economic activity and consumer discretionary spending has affected nearly every sector of the U.S. economy. Small businesses have also felt these strains, and when small businesses suffer, the rest of the economy does as well. Small businesses make a substantial and stable contribution to our economic growth, consistently producing about one-half of private nonfarm GDP. If small business cannot meet their capital needs, they will be unable to fulfill their usual role in driving economic recovery.

Let me cite just a few examples. Small businesses in the retail and restaurant trade sector, which represent 90 percent of all such firms, have been particularly affected by recent economic conditions. The retail sector is estimated to have lost over 250,000 jobs in the past year. The home construction industry, where small businesses make up 80 percent of firms, has also been particularly affected by declining home values and credit market conditions.

Equipment manufacturers have also reported large declines in new orders, capital spending and technology upgrades have slowed significantly, and the drying up of liquidity has made these businesses less able to obtain loans and even meet payrolls. The global financial crisis and tight credit markets have made it harder for small businesses to borrow the money they need to meet their payrolls, create new jobs, and invest in the future.

As the son of a first generation Indian-American engineer who has been building electricity and power generators across the United States for the past 40 years, I have a particular insight into the difficulties facing small business. I hear stories about orders for new equipment and contracts for new investments slowing dramatically over the past twelve months. This illustrates stories from small business across the country we are hearing first hand and reading about in newspapers.

At Treasury, we know that much of this lack of confidence arises from concerns of suppliers and manufacturers about the availability of credit to fund and grow their business. While this is just one example of the implications of reduced credit, I am sure that your Committee has heard other similar stories. These anecdotes aggregate into a worrisome trend that we understand that we must address.

To counter these difficulties, Treasury has applied the authorities Congress provided in October to stabilize the financial system, which will promote the flow of credit, while protecting the taxpayer to the maximum extent possible. Our actions have focused on ensuring adequate capital to financial institutions in order to stabilize markets, promote increased lending, and foster improved growth and job creation.

The focus of the recently enacted legislation on assisting general bank capitalization has been part of a coordinated international effort. This assistance is helping our financial institutions to manage the illiquid assets on their balance sheets and to attract private capital. In addition, we have broadened the Capital Purchase Program to smaller community banks which interact on a day-to-day basis with small businesses. Importantly, many of these privately held institutions have strong, long lasting ties with local businesses. By providing capital to such institutions, Treasury is directly assisting small businesses so that they have the ability to make loans, mitigate funding pressures, and promote growth locally,

These actions, in turn, will provide stability to markets and restore our financial institutions' ability to provide capital flows to the consumers and businesses that rely on stable funding to support their normal economic activity. Strengthening balance sheets of the financial sector will directly benefit small businesses.

In addition to providing capital directly to banks, we are also examining strategies to support access to credit outside the banking system, such as credit card receivables, which are very important for consumers and small businesses. This market is currently in distress – costs of funding have skyrocketed and new issue activity has come to a halt.

Today, the illiquidity in the asset-backed securitization market is affecting the availability of car loans, student loans, and credit cards. With the Federal Reserve, we are exploring the development of a liquidity facility for highly-rated AAA asset-backed securities. Such a facility could lower costs and increase credit availability for consumers and small businesses. Addressing the needs of the securitization sector will help get lending going again, helping consumers and supporting the U.S. economy.

It will take time for the measures we have taken to have their full impact on an economy in which many consumers and businesses are struggling. But in recent days, we have seen some encouraging signs. The market for lending between banks has loosened considerably, and the Federal Reserve's efforts to stabilize the commercial paper market have provided businesses with an urgently needed source of financing for day-to-day operations.

To conclude, Treasury is very mindful of the challenges and difficulties affecting the small business community. With this pressure in mind, we will continue to focus on stabilizing the overall financial markets, strengthen the banking system, and reestablish the flow of credit so that small business, consumers, and all Americans can more easily obtain credit, and thus grow and expand their businesses.

Thank you for the opportunity to appear today. I will be happy to take your questions.

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