

**FULL COMMITTEE HEARING
ECONOMIC STIMULUS FOR SMALL BUSINESS:
A LOOK BACK AND ASSESSING NEED FOR
ADDITIONAL RELIEF**

**COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF
REPRESENTATIVES**

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CONTENTS

OPENING STATEMENTS

	Page
Velázquez, Hon. Nydia M.	1
Chabot, Hon. Steve	2

WITNESSES

Connelly, Mr. Arthur, Chairman of South shore Bank , on behalf of the American Bankers Association	4
Oates, Mr. David, President, Oates Association on behalf of the American Council of Engineers	5
Bernstein, Ms. Rachelle, V.P. and Tax Counsel, National Federation of Independent Business	7
Zandi, Dr. Mark, Chief Economist, Moody's Economy.com	9
Myles, Mr. William, Myles and Myles Retirement Planners, on behalf of the Western Economic Council	12

APPENDIX

PREPARED STATEMENTS:	
Velázquez, Hon. Nydia M.	27
Chabot, Hon. Steve	28
Altmire, Hon. Jason	29
Connelly, Mr. Arthur, Chairman of South shore Bank , on behalf of the American Bankers Association	30
Oates, Mr. David, President, Oates Association on behalf of the American Council of Engineers	40
Bernstein, Ms. Rachelle, V.P. and Tax Counsel, National Federation of Independent Business	44
Zandi, Dr. Mark, Chief Economist, Moody's Economy.com	55
Myles, Mr. William, Myles and Myles Retirement Planners, on behalf of the Western Economic Council	48
Cochetti, Mr. Roger, Group Director, the Computing Technology Industry Association	57

HEARING ON ECONOMIC STIMULUS FOR SMALL BUSINESS: A LOOK BACK AND AS- SESSING A NEED FOR ADDITIONAL RELIEF

Thursday, July 24, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:19 a.m., in Room 1539, Longworth House Office Building, Hon. Nydia M. Velázquez [Chair of the Committee] Presiding.

Present: Representatives Velázquez, Shuler, Cuellar, Altmire, Clarke, Chabot, Bartlett, and Davis.

Chairwoman VELÁZQUEZ. Good morning. I call this hearing of the House Small Business Committee to order.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

Even in a free-market economy, certain conditions call for swift and sweeping government action. This February, in the face of rising unemployment and an escalating housing crisis, Congress took just that. In an overwhelmingly bipartisan effort, we passed this year's most critical piece of financial legislation. The Economic Stimulus Act of 2008 was a landmark bill and has helped to stem the effects of what has become a full-blown recession.

As of today, 130 million American families have collected stimulus checks. Meanwhile, the country's 26.8 million small businesses have enjoyed significant tax write-offs for investments. Altogether, these incentives accounted for a \$152 billion shot to the lagging economy.

The stimulus package was more than a Band-Aid resolution. It succeeded in blunting the effects of what would have otherwise been a crippling downturn. The individual rebates, for example, drove a spike in consumer spending. By late May, retail sales have climbed 1 percent, and the early indicators show that they continue to rise in June. In fact, many retailers report gains of 4.3 percent. These trends were especially helpful to small businesses, which tend to be the largest beneficiary of consumer spending.

The stimulus package did more than just incentivize consumers. It also galvanized small businesses by promising instant write-offs and tax breaks on purchases. In doing so, this particular inducement has done more than just encourage small business commerce. It has the potential to put cash back in the pockets of our entrepreneurs. These rebates have done a great deal to bolster our struggling financial market.

Yet, despite their many benefits, the economy has a long way to go. Rising inflation and climbing unemployment rates have dampened this spring's financial uptick, and we are now facing a perfect storm of financial crisis. But as today's hearing will show, this is not about looking backward, but forward. In addressing our economic woes, we must focus on ways to stimulate our small businesses. After all, they make up 99 percent of American enterprises, employ more than half of the country's workforce, and are the backbone of our economy.

A framework that grows on a combination of tax incentives and targeted investment would allow small firms to build off of the first stimulus package. Several proposals have been suggested for accomplishing this. These ideas include a second round of stimulus checks, increased infrastructure spending, and a payroll tax holiday.

In this vein, I plan to introduce a bill later today to address certain tax challenges facing small firms. The Small Business Tax Modernization and Stimulus Act of 2008 will update outmoded tax codes, thereby correcting many of the inequities currently facing small firms.

While looking for ways to stimulate our small businesses, it is important to search for solutions that have both long and short-term effects. Infrastructure spending, for example, will promise a little of both. Not only would it give an immediate boost, but it will also set up a series of returns down the road.

We now know that the first stimulus package created a foundation for economic turnaround. Today, we will look at ways to build on that framework. As we move forward, we want to make certain that we provide maximum opportunity for our small businesses to grow. In past recessions, entrepreneurs have succeeded in bringing our economy back on track. This time around promises to be no different.

I am pleased that today's witnesses could join us for this important discussion, and look forward to their testimony.

With that, I now yield to Ranking Member Chabot for his opening statement.

OPENING STATEMENT OF RANKING MEMBER CHABOT

Mr. CHABOT. Thank you, Madam Chairwoman, and thanks for holding this hearing on the role that small businesses play in supporting our economy. I would like to welcome our distinguished panel of experts this morning, who have taken time out of their busy schedules to provide us with their views, and I want to especially thank Bill Myles from my district in Cincinnati, Ohio, whom I will be introducing later.

Madam Chairwoman, small businesses, like all Americans, are concerned about the slowing growth of the economy. Energy prices are high. Too high. The stock market is lagging, people are losing their homes, and the U.S. dollar has weakened. Small businesses have been particularly hard hit by this confluence of factors.

The economic stimulus package that was passed in a bipartisan manner early this year I think was the right thing to do. It was a temporary solution or fix to a problem as we saw it. It was one of those things that oftentimes has happened too rarely, both under

Republican control and Democratic control, and that is something that happens in a bipartisan matter, and quickly. I supported it, as did you and most other Members of Congress. As I say, I think it was the right thing to do. But there are a lot of other more permanent things which need to be done, and I will get into those now.

We need a comprehensive approach to stem rising energy prices, for example, to create more job and strengthen our economy. First, we should increase domestic oil production, invest in renewable fuels, and increase incentives for energy efficiency and new technologies. I strongly believe the most critical step toward reducing the price at the pump is boosting domestic oil production by opening Alaska's Arctic National Wildlife Refuge, or ANWR, and the Outer Continental Shelf, to environmentally responsible energy exploration. Until we can further develop cost-effective alternative energy solutions, we need more domestic oil production to help lower gas prices and move towards energy independence.

Again, I want to emphasize that I also firmly believe that the alternative and renewable energy sources, whether it is wind, solar, biomass, are also an important part of this, and we need to emphasize that as well as ANWR and the Outer Continental Shelf and building new oil refineries, and the rest.

Second, we need to make the 2001 and 2003 tax cuts permanent. These cuts included an across-the-board tax cuts for all working Americans, which is especially helpful to small businesses, since most of those folks file as individuals. In addition, this relief increased the child deduction, raised the student loan interest deduction, and eliminated the death tax. Of course, that was over time because we didn't have the votes in the Senate to make elimination of the death tax permanent. And as we all know, because we didn't have the votes in the Senate, that, what I believe is an egregious tax, will come back again very soon if we don't do something about it. Taxpayers will face the biggest tax increase in history if these that I have mentioned and others are allowed to expire.

The chairwoman has called a number of hearings on health care, and I think we share a concern about the high cost of and access to health care. I believe we should continue to try to find innovative ways to make health care more affordable and accessible to small businesses.

Finally, we must eliminate wasteful Federal spending. Our Nation's long-term fiscal health depends on cutting spending and working towards a balanced budget. The Congressional Budget Office estimates that for the first three quarters of 2008, the Federal Government incurred a budget deficit of \$268 billion, more than twice the deficit recorded for the same period last year.

These steps would help all Americans and especially our Nation's small businesses through our challenging economic environment.

I again want to thank the chairwoman for holding this hearing, and I look forward to the testimony of all the witnesses here this morning, especially the witness from Cincinnati.

I yield back.

Chairwoman VELÁZQUEZ. Thank you, Mr. Chabot. I am pleased to welcome Mr. Arthur Connelly. He is the Chairman elect to the American Bankers Association. Mr. Connelly is also Chairman of

South Shore Savings Bank. The American Bankers Association represents banks of all sizes on issues of national importance for financial institutions and their customers.

Mr. Connelly, welcome. You have 5 minutes to make your presentation.

STATEMENT OF ARTHUR CONNELLY, CHAIRMAN, SOUTH SHORE BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. CONNELLY. Thanks very much, Madam Chairwoman, Ranking Member Chabot, and members of the Committee. My name is Arthur Connelly. My bank is a 175-year old mutual institution just south of Boston, with \$950 million in assets.

Our nation is certainly facing difficult economic conditions. However, I want to say at the outset that I am, and my banking colleagues across this country are very positive about our nation's economic future. Our nation has faced these challenges before and has emerged much stronger as a result.

This is not to minimize the problems that are occurring today, whether they are from job losses, struggles to avoid foreclosure, or just trying to meet the daily needs in the face of high gas and food prices. These economic weaknesses will take many months to resolve, perhaps even several years. We need to collectively look for solutions that will ensure a fast recovery.

The focus on small businesses is important now, as they are drivers of new ideas, new employment, and new economic growth. The vast majority of banks in our country are community banks, small businesses in their own right. In fact, 3,500 banks, 41 percent of the industry, have fewer than 30 employees. Small banks like mine have been an integral part of our communities for decades, and we intend to be there for many, many more years to come.

We continue to work to help resolve financial problems as quickly and judiciously as possible. Indeed, the process of economic adjustment is well underway, helped by Federal Reserve action and the economic stimulus package, Congressional actions, including improvements to the FHA program, the reform of the GSEs, and the temporary FHA program to assist distressed borrowers should all provide helpful tools, and we applaud those efforts.

Before turning to a few suggestions for changes, however, I know that many of you may be wondering about the health of the banking industry in light of the recent failure of IndyMac. Let me assure you that the industry as a whole remains fundamentally strong. Ninety-nine percent of banks are currently classified by regulators as "well capitalized," the highest possible designation. We have the capital and the reserves to continue to make loans that are so vital to each and every one of our communities.

Changes are needed, however, particularly to avoid a severe credit crunch. The secondary markets have already reduced the amount of credit available for residential and commercial real estate. ABA recommends a thorough discussion of securitization accounting rules to ensure credit can flow from this source.

Moreover, FASB's so-called fair value rules often fail to reflect intrinsic values or provide accurate and useful information to investors. ABA recommends that these rules be revised immediately.

The credit crunch can also stem from an over-reaction on the part of bank regulators. They are combing through banks' books, looking for anything to criticize. This clearly has a chilling effect on the willingness of a banker to make new loans to deserving individuals and small businesses that need help today. While banks will naturally be more conservative as the economy weakens, pressure to write down the value of loans where payments are current will have a devastating effect on the availability of credit.

Finally, I want to mention an issue that has arisen very recently, the problem of naked short-selling, as well as the repeal of the uptick rule, which has had a dramatic impact on many publicly traded banks, large and small. In spite of the strength of the industry and the backstop of the FDIC, our members are reporting that bank customers are equating stock drops with the safety of their deposits.

While the SEC's Emergency Order helped stop a speculative practice for a few large institutions, it really did nothing to help small banks. The ABA recommends that the SEC take immediate action to stop inappropriate short selling for all publicly traded banking institutions.

Madam Chairwoman, we understand that you are about to drop a tax bill for small businesses. We want you to know that the ABA strongly supports initiatives like this one to address the concerns of small business.

I appreciate the opportunity to be here today, and would be pleased to answer any questions.

Thank you.

[The statement of Mr. Connelly can be found in the appendix at page 30.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Connelly.

Our next witness is Mr. David Oates. He is the President of Oates Associates, Incorporated, a civil and structural engineering firm operating in the St. Louis area for over 40 years. Mr. Oates is here to testify on behalf of the American Council of Engineering Companies. ACEC and its member firms employs thousands of engineers, architects, land surveyors, scientists, and other specialists. Its members are responsible for more than \$200 billion of private and public works.

We welcome you.

STATEMENT OF DAVID OATES, PRESIDENT, OATES ASSOCIATES, INC., ON BEHALF OF AMERICAN COUNCIL OF ENGINEERING COMPANIES

Mr. OATES. Thank you, Madam Chairwoman, and members of the Committee. I appreciate the opportunity to testify before you today about the importance of a safe and efficient transportation system to our economy and the role that transportation and infrastructure investments play in promoting economic growth.

As mentioned, my name is David Oates, and I am President of a civil and structural engineering firm in the St. Louis area. My firm currently employs 40 civil and structural engineers. I am also an active member of the American Council of Engineering Companies, or ACEC, the trade association of America's engineering industry. I currently serve as ACEC's Transportation Chair.

On behalf of myself and ACEC, I urge you to include spending on our Nation's transportation and environmental infrastructure as you consider legislation to stimulate the faltering economy. I was very pleased yesterday to see the House pass H.R. 6532, a bill that addresses the impending shortfall of revenues in the Highway Trust Fund, which could lead to a 34 percent cut in your State highway program. I hope the Senate will act quickly on that legislation.

But much more can and should be done beyond a short-term fix to the Highway Trust Fund. Additional spending on infrastructure, from roads and bridges, to sewer and drinking water systems, will provide a near-term boost to our economy through job creation, at the same time provide long-term benefits to our economy.

My firm is involved in all manner of public work projects, but my passion and experience lie in the transportation field. So I will direct the majority of my comments to those matters. My written testimony contains much more information on water and environmental infrastructure.

Transportation and transportation-related industries account for 10 percent of the U.S. Gross Domestic Product, and there is well-documented evidence of the direct correlation between transportation spending and job creation. One commonly cited study from the Department of Transportation found that 47,500 jobs were associated with \$1 billion in infrastructure spending.

My firm and others in the transportation and engineering construction industry support well-paying engineering and construction jobs. Additional spending on transportation projects and programs will foster immediate job creation, but it is also important to appreciate the long-term benefits to our national economic competitiveness.

The primary purpose of the Federal Surface Transportation Program is the safe and efficient movement of people and goods, which contributes to economic growth by facilitating on-time manufacturing and delivery, making personal business travel easier and reducing congestion and maintenance costs.

Transportation investments also strengthen local and regional and State economies, and in turn generate additional tax revenue by allowing businesses to expand operations and hire more workers. Inadequate funding for transportation has led to deterioration, congestion, and delays, all of which raise the price of doing business through maintenance and repair needs, wasted fuel, and delayed cargo shipments.

Last year, our national economy was crippled by nearly \$80 billion in congestion costs. On the safety side, traffic accidents and fatalities, beyond their personal impact, exact a \$230 billion dollar annual toll in economic costs.

The National Surface Transportation Policy and Revenue Study Commission concluded that we need \$225 billion minimum annual investment to upgrade our system to a state of good repair and create more advanced sustainable system.

The massive quantity of transportation and infrastructure needs are certainly not going to be met in one piece of legislation, but the American Association of Highway Transportation officials has identified over 3,000 ready-to-go projects that would be sped up through

additional near-term spending. An influx of additional funding would allow State DOTs to move forward with projects that are currently on hold.

In my State, the Department of Transportation has identified 200 ready-to-go projects in need of \$2 billion in funding, and these projects won't just go to huge multi-state firms. Small businesses like mine will benefit greatly from contracting and opportunities from this additional funding.

By boosting infrastructure spending you can take an important step toward fixing structurally deficient bridges, rebuilding crumbling roads and highways, and the best part is that these are truly investments. We are building structures this will last and will provide added value for years and years. There is both a short-term stimulus and a long-term gain.

On behalf of ACEC and the Nation's engineering industry, I want to thank this Committee once again for focusing attention on this important issue.

I would be happy to answer any questions.

[The statement of Mr. Oates can be found in the appendix at page 40.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Oates.

Our next witness is Ms. Rachelle Bernstein. She is the Vice President and Tax Counsel for the National Retail Federation. Ms. Bernstein joined NRF in 2004, following 13 years as outside tax counsel to the NRF Government Relations Department. The National Retail Federation represents an industry with more than 1.6 million U.S. retail companies and more than 25 million employees. Welcome.

STATEMENT OF RACHELLE BERNSTEIN, VICE PRESIDENT/TAX COUNSEL, NATIONAL RETAIL FEDERATION

Ms. BERNSTEIN. Thank you very much, Madam Chairwoman, Ranking Member Chabot. I am Rachelle Bernstein, Vice President and Tax Counsel for the National Retail Federation, which is the world's largest retail trade association. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees, about one in five American workers, and 2007 sales of \$4.5 trillion. Most retailers are small businesses. Ninety-six percent of retail companies have only one location.

Chairwoman Velázquez, Ranking Member Chabot, members of the Committee, NRF commends you for holding this important hearing to evaluate the impact on small business of the economic stimulus package enacted earlier this year and assess the need for additional relief.

Early this year, Congress and the administration worked together in a bipartisan fashion to enact economic stimulus legislation to aid a slowing economy. The NRF commends the Congress for its quick action to address the Nation's economic needs. Because consumer spending represents 70 percent of the GDP, we believe that the tax rebate payments were particularly important. Today, we would like to share with the Committee what we have learned to date about the impact of these tax rebates.

In the current economy, most categories of merchandise and most types of retail outlets are struggling to achieve even modest sales

increases. Tax rebate payments are providing some stimulus, but consumer spending remains subdued because of the stresses of declining home values, escalating food and fuel costs, increasing unemployment, and weak financial markets. Consumers are concentrating their spending on essentials. They are also more concerned than ever with the pricing of merchandise. Consumers are shopping more online so that they can more easily make price comparisons and also save money on gas.

For small retailers, this economic climate is even more difficult than for larger retailers. Small retailers tend to compete more on service than on price. Because small retailers cannot benefit from economies of scale, they are hit harder than other merchants by rising costs, particularly the rising cost of fuel. Small retailers who do not sell their goods online are not able to take advantage of the shift to online sales.

Direct deposit of tax rebate payments began the last few days of April, followed by the mailing of the rebate checks through July 11 for eligible taxpayers who filed a tax return. After a decline in retail sales in March, there has been a bump in retail sales of general merchandise for April, May, and June, which we attribute to the distribution of the tax rebate checks.

The April bump in retail sales was .6 percent seasonally adjusted month to month, which was the largest month-to-month increase since November of 2007. With substantially more checks distributed in the month of May, amounting to more than \$40 billion in rebates, retail industry sales increased by .9 percent. Most of the May sales went to discounters and grocers, although some shoppers splurged on electronics and appliances.

The Treasury Department distributed almost 30 billion in the month of June, but consumer spending remains soft, with an increase of .2 percent. Most of this increase seemed to be focused on necessities.

A survey of consumers' use of tax rebate checks was performed by Big Research the week of June 3 through 10. As of that date, 45.3 percent of survey respondents had received their tax rebates, and 42.9 percent said they used the money to purchase something. However, nearly half of that money was spent on gas or necessities such as groceries rather than general merchandise, as envisioned when the rebate check program was passed by Congress. And 17.1 percent of the respondents initially saved their rebate money, but it appears that they may have set it aside for purchases in upcoming months.

In survey findings released just this week, NRF found that one-fifth of parents nationwide have set aside a portion of their stimulus check for back-to-school purchases. Specifically, parents say they will use some of their tax rebate check to fund electronics, such as computers and cell phones.

Despite a more modest increase in retail sales over the last few months than was expected from the rebate checks, we believe the results are better than they would have been if Congress had not enacted these rebates. Based on the economic information that is currently available, we believe that a compelling case can be made for providing additional economic stimulus legislation.

If Congress does act on a second stimulus package, we believe it should once again include relief for the consumer. Since consumer spending is the largest contributor to GDP, it is difficult to foresee an improvement in overall economic growth until consumer spending improves.

Chairwoman Velázquez and members of the Committee, thank you again for the opportunity to speak to you this morning. I would be happy to answer any questions.

[The statement of Ms. Bernstein can be found in the appendix at page 44.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Bernstein.

Our next witness is Dr. Mark Zandi. Mr. Zandi is the Chief Economist and Cofounder of Moody's Economy.com in West Chester, Pennsylvania. He received his Ph.D. At the University of Pennsylvania. At Moody's he directs the company's research and consulting activities. Moody's Economy.com is an independent subsidiary of the Moody's Corporation, and a leading provider of economic research and consulting services.

Welcome.

**STATEMENT OF DR. MARK ZANDI, CHIEF ECONOMIST,
MOODY'S ECONOMY.COM**

Mr. ZANDI. Thank you. Thank you, Chairwoman. Thank you, Committee, for the opportunity to be here today. Let me say these are my personal remarks and not representative of the Moody's Corporation.

I have strong support for the idea that we need a second fiscal stimulus plan. I think that is a very laudable idea and is much needed in today's economy. I think the plan should be timely so that the stimulus gets to the economy by early 2009. I think it needs to be targeted to lower income, middle income households that will spend the money quickly, and to small businesses that will use the money quickly to support hiring and investment of their further activity, and that it should be temporary. It should not lift the long-term Federal budget deficit. That is a very significant problem that we are going to face in coming years, and we don't need to add to that problem.

So timely, targeted, and temporary. I think those are the key criteria.

I support the idea for a second stimulus plan for three reasons. Reason number one, the economy is still very weak. We have lost over 400,000 jobs since the beginning of the year. They are very broad-based. It is not just housing, vehicle manufacturing; it is retail, it is financial services, it is information services, it is professional services. In fact, there are only two industries that are adding to payrolls in a consistent way, and that is health care and educational services. That is it.

The job losses are broad-based across the country. In my view, 19 States are in recession. Ohio is one of those States. California, Arizona, Nevada, Michigan, Rhode Island. They are all over the country. There are many other States that are very close to recession, and probably will be in recession before this is all said and done.

The problems the economy faces are persistent. They are not going away quickly. The housing downturn is in full swing. Price declines will continue through this time next year, even under the best case scenario.

The problems in the financial system are well-entrenched. The banking system is writing down problem loans, and that will continue for the foreseeable future. High energy and food costs are a significant drain on the economy that aren't going to go away. So I think the economy's problems are persistent.

The second reason for my support is that the benefits from the first stimulus package are fading. The tax rebate, which was the principal element of the first stimulus package, about \$100 billion, that has lifted retailing activity in April, March, and June. Talking to retailing clients that I have, they already are seeing retail sales are falling off quite dramatically in the month of July, so we are seeing it fall off very rapidly.

The investment tax benefits, they of course expire at the end of the year, and what they have done is in a modest way pushed investment forward into this year, stealing away from investment for next year, so if those investment tax benefits are not extended, then there will be a payback in early 2009 with less investment by businesses. So the stimulus is going from a plus, and it will be a negative later this year into 2009. So a second reason for support.

The third reason for support is monetary policy can't help. The Federal fund rates target is 2 percent. It is not going to go any lower. There are concerns about inflation. I don't think that means the Reserve will tighten monetary policy soon, but what it surely means is that this is not going to be any further easing of policy. Interest rates are not going any lower. So we can't count on that. So if policymakers are going to stimulate the economy, it has to be Congress and the economy. It has to be fiscal stimulus.

So those are the three reasons for support. What should the plan look like? I think it probably should be \$50 to \$100 billion. That would be equal to the difference between what economists think is going to happen next year and what the economy should grow in a normal, well-functioning environment, the difference between what we think growth will be and what economists call the potential growth, that growth necessary to maintain a stable rate of unemployment.

Most economists, including myself, believe that unemployment will rise into 2009 if the economy doesn't experience stronger growth. In fact, the unemployment rate today is 5-1/2. Most economists think it will be between 6 and 6-1/2 percent by the spring, summer 2009. Of course, that understates the stress in the job market. Many people are being pushed from full-time to part-time employment. They are still working but losing overtime hours. So there is a lot of other stress. So that \$50 to \$100 billion would go a long way to filling that gap.

And if economists are wrong and the economy turns out to be better, that is not a real problem. We have a 5.5 percent unemployment rate. We could use a little bit of extra growth anyway to bring that rate down, back to where most economists would think is full employment, which is below 5 percent. So I don't think there

is much downside to being wrong. It would be nice if we were wrong.

In terms of what should be in the plan, I am going to throw out some ideas, all of which are more or less good, some better than others, but it depends on circumstances.

I think extending the Food Stamp Program would be a great idea. You can implement that quickly. You can have it out there in 60 days. All research shows people spend that within 30 days after that. These are going to help low-income households struggling with the high food costs. It is killing them. I think that would be helpful, a very efficacious kind of policy.

I think a gas tax holiday is a good idea. I think that would help people who are struggling, low-income households that are struggling to get to work, driving long distances, and any help they can get in terms of tax relief there, I think would be helpful.

Those are for consumers. For businesses, I would extend the investment tax benefits for another year. I don't think the cost to Treasury is very significant, and I think that would at least take away that drag that will be on the economy in 2009, particularly for small businesses that will face higher costs because of that.

Here is a little bit of a stretch, but I think a payroll tax holiday would be a very good idea. It would go to low-income households, people who don't pay income tax but work and pay payroll tax, and to small businesses, because that will be a cash infusion to them that they can use to hold on to their workers and to investment. So those are for businesses.

For government, aid to State and local governments would be very good. There was a very good piece in the Journal today about the size of the fiscal problem States are facing. They are going to cut back on Medicaid and other infrastructure. That would be very beneficial, to get them some help to forestall some of those cuts.

Finally, infrastructure spending. The only caveat there is you have got to figure out how to cut the checks quickly. If you can't, then it is not worth it. Criteria number one is timeliness. If it is not timely, it is not stimulus. It is not counterproductive. So if you can marry stimulus with infrastructure, that is great. But you have got to figure out how to execute. That is very important.

With that, I will stop. Thank you for the opportunity.

[The statement of Mr. Zandi can be found in the appendix at page 48.]

Chairwoman VELÁZQUEZ. Thank you, Dr. Zandi.

And now I will recognize Ranking Member Mr. Chabot for the purpose of introducing our next witness.

Mr. CHABOT. Thank you, Madam Chairwoman. I am pleased to introduce William Myles from Cincinnati, Ohio. Bill serves as Vice President and member of the Board of Directors at the Western Economic Council, an organization created 20 years ago to promote economic development and community pride in western Hamilton County, Ohio. He is a retirement planner with the firm of Myles and Myles located in Covington, Kentucky.

Bill has been working with clients for over 30 years in the firm that his father founded back in 1965. He is also a member of the leadership team of Agenda 360, an economic development strategic plan for Cincinnati and its surrounding counties.

A graduate of the Citadel, Bill lives with his wife Barb in the Cincinnati neighborhood of Bridgetown. We are pleased to have him here this morning, and look forward to your testimony. Thank you.

STATEMENT OF WILLIAM MYLES, MYLES & MYLES, RETIREMENT PLANNERS, ON BEHALF OF THE WESTERN ECONOMIC COUNCIL

Mr. MYLES. Thank you, Chairwoman Velázquez, Ranking Member Chabot, and all the members of the Committee for the opportunity to speak today. The Western Economic Council was founded 20 years ago as a nonprofit economic development group. Today, our members represent nearly every aspect of life in the western suburbs of Cincinnati, Ohio. As members, we voluntarily work to foster a greater economic and built environment for our region.

In an effort to prepare for this hearing, I asked our members a number of questions on the subject. Much was revealed after several dozen conversations.

Consumer rebates are being used in every imaginable way. Recipients I spoke with are respectively paying bills, buying gasoline, buying a high definition television, going on a trip, investing in long-term savings, putting the money on the side for a time when they may need it, and everything in between.

Who would argue any payments to consumers is not in itself positive for the economy? An \$1,800 check to a family of four with adjusted gross income of \$70,000 is, by any measure, something of a windfall.

One of our members shared a report of the International Shopping Centers Trade Group from earlier this year. It reported their tenants were crediting increased sales to the rebates. Last week, the same group reported those sales had leveled off and it expects a record number of their tenants will go out of business in 2008.

The anecdotal conclusion of the great majority I canvassed is that consumer rebates are helpful, yet not enough to lift the economy out of a low spot in the business cycle. Rebates may never be reliable at stimulating the economy because they don't guarantee the desired change in behavior.

Conversely, tax deductions are inherently reliable. Generally, our members feel a better short and long-term approach is to target benefits to those who have directly invested in the means of production of goods and services.

The owner of a home improvement company hesitated last year to buy additional equipment. This year it is a different story. He will hire more people to use this new equipment because of the tax benefits to small business. He, and others like him, will be creating a recurring \$1,800 payment to newly hired workers.

If the goal is to assist those suffering through a particular hardship, such as avoiding home mortgage foreclosure, perhaps specific legislation will be more efficient than broad, one-time consumer rebates as a solution. This was, along with transportation infrastructure improvements, a common alternative to consumer rebates suggested by our members.

Perhaps in the fullness of time empirical data will reveal the true impact of the Economic Stimulus Act of 2008. In the mean-

time, however, our members value the tax incentives as having a greater effect on their businesses than consumer rebates. They very much want you to know that continuing the tax incentives to small businesses is critical fuel for what has become the engine of the American economy.

Thank you again on behalf of all our members.

[The statement of Mr. Myles can be found in the appendix at page 55.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Myles.

Mr. Connelly, if I may, I would like to address my first question to you.

Due to the problems at Fannie Mae and Freddie Mac, the rise in foreclosures, and most recently the failure of IndyMac, many are calling for increased intervention. Secretary Paulson is among those who believe that this is necessary.

What solutions do you favor to return stability and liquidity to financial markets, without being overly burdensome?

Mr. CONNELLY. Thank you, Madam Chairwoman. We think that the housing bill is a great start. Establishing a level playing field regulating nonregulated mortgage lenders is essential. More importantly, it is essential to find a balance. Extreme caution is necessary. Consistent prudence and moderation on the part of the regulator is critically important. Prudent and responsible reporting on the part of the media is important.

We have heard a lot in the last week or so about the list of troubled banks in this country. It is critically important to understand that 99 percent of the banks in this country are well capitalized, number one.

Number two, that 87 percent, historically, 87 percent of the banks that have been on FDIC's problem bank list have successfully worked their way off.

So FDIC's list is a meaningless to the public unless they have the backup data that should be confidential and the public shouldn't have while forbearance and due diligence is being exercised.

So I think caution and balance is the most important thing and doing everything we can to control inflation.

Chairwoman VELÁZQUEZ. Thank you.

Dr. Zandi, as you know, any stimulus enacted could put a further strain on our national debt. Is there potential concern that the short-term benefits created by the stimulus package could be outweighed by the long-term effect of increases to our national debt?

Mr. ZANDI. Not if well designed. A key criteria for a fiscal stimulus plan should be that every element of it is temporary, that it is not something that is put into law for except a very brief period of time. Therefore, it would add to the deficit in that window. That is the idea. That is how you get stimulus. You are borrowing money and you are using that to put into the pocket of business people and consumers so that they put it into the economy right away.

Now that would be a problem if you kept borrowing money because investors would say, Oh, you're going to borrow a lot of money. You're going to have to pay a high interest rate. But if you go to them and say you are borrowing once for these things, then

they won't charge you a higher interest rate for it so you get the benefit with no cost.

Anything you do that has long-lasting consequences would be counterproductive and detrimental.

Chairwoman VELÁZQUEZ. Ms. Bernstein, you spoke about the effect of the first stimulus package in terms of the rebate checks that were issued, how it boosted consumer spending, and you talk about the surveys that you conducted right after May, June and July, and in all those first months after the rebates were issued you saw consumer spending going up, then in July it is dropping.

Ms. BERNSTEIN. It is still unclear to me what is happening in July. Obviously, we don't have the results of the month yet. I can tell you anecdotally I have heard from some retailers who, based on the first week of July, think that the results may be better than they were in June. So I think it is just a little too early to be able to make an analysis of that situation. Remember, the checks kept coming out through July 11.

Chairwoman VELÁZQUEZ. But it is your opinion that it really provided some short-term boost to the economy?

Ms. BERNSTEIN. Absolutely. Absolutely.

Chairwoman VELÁZQUEZ. Mr. Oates, you touched on the benefits derived from increased infrastructure spending, but I did not hear how it will affect overall GDP. I ask this question because Chairman Bernanke indicated last week that our economy will grow appreciably lower below its rate, and likely be around 1.6 percent for the remainder of the year. Are you aware of any correlation between infrastructure spending and increases in our GDP?

Mr. OATES. Yes. Standard & Poor's reports that every dollar invested in highway infrastructure or highway construction generates about \$1.80 in Gross Domestic Product in the short term. As I said in my testimony, transportation and transportation-related industries account for 10 percent of the U.S. Gross Domestic Product.

So when you look at those two factors, the influence of additional investments in transportation and infrastructure on the overall economy could be substantial. Also, the efficiency of highway improvements affects the economy. Researchers from New York University show that every dollar invested in the Nation's highways generates about 30 cents of production cost savings to businesses every year. So over 4 years you would get a return on that investment. That same study estimated that highway investments contributed an average of 25 percent of total productivity gross nationwide over the last 40 years.

Chairwoman VELÁZQUEZ. Mr. Oates, you mentioned the 3,000 highway projects that are ready to go and the money is there. The problem that I see is that many small businesses rely on contracts from agencies other than DOT. Do you know of any other government agencies that have similar contracts in that ready-to-go phase?

Mr. OATES. I can speak for the clients that we have in our local area, the counties and cities that we do work for. If they had, and as Dr. Zandi said, if they had a check or had assurance of funding quickly, most of them have projects that they can move ahead and get started on if something happens quickly. So, yes, there are a

number of our clients are waiting for funding for projects that they have ready to go or they can advance from next year and do some other things the following year.

Chairwoman VELÁZQUEZ. Ms. Bernstein, the second part of the stimulus involved increasing the section 179, along with allowing businesses accelerated depreciation. Are you aware of any evidence empirically or anecdotally that those in your industry have been using the tax breaks to buy new equipment or make investment?

Ms. BERNSTEIN. I can only give you anecdotal information. What I have learned from retailers is that as this year began and the economy was so soft, they continued with projects that had to be done or where they were committed to a contract that they couldn't get out of. In terms of new spending on improvements that might be needed or other types of equipment that they might need but might not necessarily buy, people were just not spending the money because the industry was doing so badly and there was so much cutting back on expenditures.

Chairwoman VELÁZQUEZ. Dr. Zandi, you mentioned that the benefits of the first stimulus package are fading. You support a second stimulus package, but you say that it should be timely, targeted and temporary. If you are asked to say today—we are limited here in terms of how much money there is—what will be the most targeted and most productive stimulus provision that could be included in any package?

Mr. ZANDI. Well, the thing that provides the most economic bang for the buck so that every dollar you spend, you get more GDP, is the food stamp extension. That is the most obvious thing to do. Infrastructure spending is also very important, but goes to the timeliness issue. You just need to get those checks out there and have projects that work well.

Of the various kind of tax breaks, the most efficacious, the most bang for the buck, could be a payroll tax holiday. More than the income tax rebate, for various reasons.

Chairwoman VELÁZQUEZ. Why do you think that?

Mr. ZANDI. For one reason, it would benefit very low-income households. Some 40 million people are working, pay payroll tax, and don't pay much in the way of income tax. This would be a significant benefit to them. It goes right into, many cases, into their bank, checking account, and as such people spend that much more readily, much more quickly than getting a rebate check.

Also, I think it is designed to help employers. For small businesses I think that would be important. And this might help them survive. I think that would be also very effective.

The thing that is least effective would be the benefits investment. Kind of the accelerated depreciation. I am not saying that doesn't help, it is just it doesn't help as much as other things.

Chairwoman VELÁZQUEZ. Thank you very much.

Now I recognize the ranking member.

Mr. CHABOT. Thank you.

Dr. Zandi, when you said it doesn't help as much, you might be thinking, and I assume in the short term, but it has also been indicated here we get a bump-up for a couple of months, then it falls back off. If you want to do something structural, something that is actually going to benefit the economy over the long term where

small businesses may be able to grow and hire more people, which is actually perhaps better for the country and maybe employs more people and maybe means that recessions aren't as deep or that everybody does a little better over the long term, that those investment type tax cuts are important as well, aren't they?

Mr. ZANDI. I wouldn't disagree with that. Anything that raises investment obviously helps our economy in the long run. Focusing on the idea of trying to stimulate economic activity in the near term and trying to get the most out of the limited budget that you have, you are going to get less of a boost, near-term boost. I am not saying that you shouldn't have these other objectives in mind.

Mr. CHABOT. I supported the economic stimulus package, as most Republicans and Democrats did, but I think the argument that I would make is that if we can improve the overall economy over the longer term by having businesses be healthy, especially small businesses, because that is the emphasis of this Committee, that you are hiring more people and people have jobs for a longer period of time and we have a more resilient economy. So the recession, which are inevitable to some degree, will be less deep and perhaps less frequent if the country—if we grow the pie, so to speak, rather than just redistribute money, which is the alternative, even though that may help for a month or two?

Mr. ZANDI. Excellent point. Let me make one more point. Most of the benefits to the investment tax that we put in place for the stimulus package generally benefit businesses that make large investments. If you make a small investment, the actual benefit to the business is very, very small. They are much more worried about sales, much more worried about—the last thing on their list is the so-called cost of capital, particularly for small equipment. It is not going to much a big difference. They know that ultimately down the road their tax bill is going to be higher. All you are doing is shifting the tax liability from today to tomorrow. And they know that. That tax benefit that you have probably benefits bigger companies that make big equipment purchases. That benefits them more than the small businesses.

Mr. CHABOT. I have quite a few small business folks in my community that have told me they have directly taken advantage of those, and that enabled them to do better than they otherwise would and keep employees on longer and sometimes hire more, which is what we want to do.

Mr. Myles, let me go to you if I can. In your retirement planning and that sort of thing, how important would it be in long-term planning if, for example, we made the tax cuts that we passed in 2001 and 2003 permanent and if we did some structural things like simplify the Tax Code and people could rely on it for longer periods of time so they didn't worry about us changing things around. How much would that have to do with improving the overall economy and peoples' lives?

Mr. MYLES. There is nothing you could do that would be more important than that. That is simply the number one planning challenge. I can't say it any better than you just did.

Mr. CHABOT. Right now you don't know what we are going to do and you don't know that the tax cuts are going to continue or not because at this point next year they are going to—a lot of them are

going to go out of existence and the taxes will go back up to the levels that they were some years ago, and a lot of Americans aren't aware of that, quite frankly. Is that your understanding?

Mr. MYLES. It is very much so, from the estate tax on the top end, to the savers' tax credit for those most modest earners among us. Very true.

Mr. CHABOT. Thank you.

Ms. Bernstein, if I could go to you next. You had mentioned with reference to the economic stimulus package and how people utilized it and what they spent it on, I think you said half of those actually spent it, ended up spending it on gas or fuel of some sort and food.

Ms. BERNSTEIN. Right.

Mr. CHABOT. So how important is it that we get a handle on this energy crisis that we find ourselves in in this country?

Ms. BERNSTEIN. I think it is important to get a handle on it for many different reasons. Not being an economist, I don't know how quickly that can be put into place and whether that will—how well that can affect the immediate situation. But from the retail perspective, we are hit by it in many ways. Obviously, to the extent that consumers are using their wages or rebate checks or whatever money they have to spend on gas instead of spending it on other things and get the same amount of gas, that is a real problem for the retail industry, which is really suffering.

In addition, obviously the fuel costs are very high for retailers that must get their inventories to their stores. For small retailers that don't have the benefits of economies of scale, those delivery costs to get things to their stores end up being that much higher and end up being something that is much more of a burden to them. So all around fuel costs are important in the retail industry.

Mr. CHABOT. Thank you. If gas was as a year and a half ago or so, \$2 something a gallon, now \$4 a gallon, and the consumer is paying that, and maybe some of that out of the economic stimulus package, if a significant portion is going to say Saudi Arabia or Nigeria, Venezuela, or wherever it is going, that portion isn't doing a heck of a lot for the retailers here locally or the overall economy. Would you agree with that?

Ms. BERNSTEIN. That would appear to be so, but I have to I say I have no particular background.

Mr. CHABOT. Thank you.

Mr. Oates, if I could go to you next. You had mentioned the importance of the highway funding and the infrastructure and all those things, which I certainly agree with you. Let me ask, how much confidence do you have in Congress, and again, I would stipulate that I mean under Republican control in the past or Democratic control now, how much confidence do you have that the decisions relative to where the highway funding ought to be spent is going to be based upon the merits as opposed to pork barrel earmark-type spending, which may end up in say a bridge in Alaska that doesn't go any place, and perhaps in a smaller State like, say, West Virginia, which traditionally has had a fairly powerful representation in the Senate and been able to direct a fair amount of money in that direction—this is a pretty long question—but would you feel more confidence; do you think we ought to adjust our thinking up here on the Hill in how we go about funding things

and should they be funded more upon the merits as opposed to some political decision making process?

Mr. OATES. They said there would be no trick questions. Talking about the stimulus package, I think both in the timeliness and how this is done, for it to be effective for infrastructure, it does need to be distributed in some way that is just straightforward grants to States and/or local communities to take care of certain infrastructure things with as few strings as possible and probably distributed by State size or community size or something like that so that the State and the local folks can decide where they need to spend that money within a certain range of parameters. If a local community has another \$500,000 that they can go spend on a sewer project or a road project yet this year, if they have that money, they will be able to do something with it and they will be able to hire people, buy supplies, it will help all different sizes of businesses.

Mr. CHABOT. Finally, Mr. Connelly, with the economy as it is today, and tighter markets, is it getting tougher or is it relatively tough for small businesses at this time to get access to credit, and did you have any suggestions as to what we can do about that.

Mr. CONNELLY. First of all, Mr. Chabot, thank you for not asking me the last question.

Coming from the home of the Big Dig, I might have a uniquely different opinion. It's business as usual in my town. Our small business lending and residential lending are up substantially over this time last year. I just spent the weekend with 300 of my closest friends, bankers from across the country, who tell me that lending is going on.

Now, admittedly, there are pockets where there are problems. We are not making loans like the old Ninja loans; you know, no income, no jobs, no assets. But we are making loans with prudence. We are looking at income and likelihood and ability to repay. It wasn't our institutions that caused the problem. So there is lending going on out there, and in some pockets there is a lot of lending going on.

Mr. CHABOT. Thank you very much. I yield back, Madam Chair.
Chairwoman VELÁZQUEZ. Mr. Shuler.

Let me just remind Mr. Chabot that bridge to nowhere is important because that is the only way to transport that oil.

Mr. SHULER. Thank you, Madam Chair. Dr. Zandi, I want to ask kind of the chicken or the egg kind of thing. What impact has the weak dollar had on both petroleum prices, other imports, food prices? Because if you look at it, the gas prices haven't gone up in Europe because of the strong Euro, but they are buying almost what, 1-1/2 to almost 2 barrels for our 1 barrel that we purchase. So what impact has the weak dollar had on the economy, or has it been the economy obviously impacted the weak dollar?

Mr. ZANDI. It is both. On net so far, the weak dollar has been a benefit to the economy in that the plus from increased trade has offset the negatives resulting from higher import prices, including the higher cost of oil and other commodities. Now oil prices are higher, commodity prices are higher because of the lower dollar because these products are traded globally in dollars, and so when the dollar falls in value, to ensure that demand and supply globally remains the same the dollar price has to rise. So there is debate

as to what degree the lower dollar has contributed to the run-up in oil prices. But, in my guesstimate, roughly \$25 of the increase in oil prices since 2002 is the dollar.

So you go back to 2002, WTI was trading for \$25. Now it is trading for \$125, and \$25 of that is the weaker dollar. That has been very negative. So taken by itself, that is a problem. But in the context of the pluses on net so far, it has been a net plus.

Mr. SHULER. So if we continue to increase the debt over the long period of time, and I know we have talked about the taxes expire. I have children, a three-year-old little girl and a seven-year-old little boy. What is the impact to our children if we don't have the revenues in hand and we continue to increase our national debt? I mean we are ultimately going to get to the point where we are upside down, and what impact is that going to have? I know the short term—we can talk about short term. We can stimulate it all we want, and instead of \$100 billion, let's put \$400 billion in. But what impact is that going to have on my children's future both 10, and 15, and 20 years down the road? If there is a shortfall in Congress that I see as everybody looks 2 years ahead because that is their next election, so what is the impact that we are going to have 10 years, 15, 20 years, and that is what we should be talking about, is what the long-term impact is going to be. Yes, we are going to increase and stimulate the economy today, but what impact will that also have in 5 years, in 10 years, and in 20 years?

Mr. ZANDI. You make an excellent point, and I think our most significant economic problem is the daunting fiscal future that we face. The arithmetic doesn't work. Something is going to break if something doesn't change. It doesn't have to happen this year, and it won't, doesn't have to happen next year, and it won't, but at some point over the next 5 to 10 years it is going to become very clear that the fiscal situation is untenable.

You have three choices, really. One is doing nothing and let the deficits increase, and that will be catastrophic because rates will rise and undermine investment, and the economy will struggle. We will have many more problems. The other option is to raise taxes. The third option is to cut spending. That is it. Those are the three choices. Obviously, they are very difficult choices that you are going to have to make, but you are going to have to make them and figure out a way to do it. But that is clearly our most significant economic problem.

Let me just say though the long run is made up of a lot of short runs, and we are now in a short run that is very debilitating and painful and people are obviously under a lot of stress, and I think we can do some things in the near term to alleviate that stress without jeopardizing our long-term economic health. That is a reasonable discussion to have, but that is not to say we shouldn't have this discussion about what we are going to do about our fiscal problems in the long run.

Mr. SHULER. I have 10 seconds. I kind of want a yes or no, or just an answer. We have to stimulate the economy, put between \$50 or \$100 billion into the economy, or more. How do you recommend we do that? Do we print more money or do we borrow it from foreign investors, like we have been? One of the two.

Mr. ZANDI. I thought you said yes or no.

Mr. SHULER. I know what the answer is. We have got two options.

Mr. ZANDI. You are going to have to borrow money.

Mr. SHULER. So we borrow money from the Chinese to ultimately buy more Chinese products. I wish I was in that business, to lend somebody money that is going to ultimately buy my products.

Mr. ZANDI. That is not quite fair. Put it into a bridge or a road.

Mr. SHULER. That would be wonderful. I yield back.

Chairwoman VELÁZQUEZ. The time has expired.

Ms. Clarke.

Ms. CLARKE. Thank you, Madam Chair. This is a great hearing, but I have to tell you I am sitting here and it is kind of scary. I want to just ask the question about infrastructure development to Mr. Oates in particular because one of the equations that I see that is sort of missing in terms of the stimulus of infrastructure is sort of the companion infrastructure, which has to do with energy that goes along with it. Because if indeed we are going to talk about rebuilding roads, we have to talk about what it costs across the board.

In terms of energy right now, we are really struggling. How are we going to pay for the oil that goes into the bulldozer or the other equipment? How are we going to move products or materials from one place to another?

One of the challenges that I think we face is how we are identifying an emerging industry, which is the redevelopment of energy and the infrastructure that we need to distribute it.

So has your organization taken a position with respect to energy and how it is distributed and what we need to put in the pipeline now? Because a lot of what we are talking about here are dealing with variables that currently exist. What has made America great is the imagination of what can exist. I think we have to move into that mode if we are going to talk about prosperity again and not this do we print money or do we borrow money scenario.

How do we create wealth again I think is the major issue that we need to be focusing on. We are trying to survive. Our kids will be struggling to survive if we don't talk about the innovation that has made America great.

So I want to know whether there have been any conversations. For instance, we are having blackouts in Brooklyn, New York, and ConEd can patch and patch and patch for as long as they want to. It is an old city. This place, as long as we continue to use the types of appliances and lifestyle that we have, we are going to constantly be going through these blackouts. No one is talking about that new infrastructure that goes along with engineering and transportation in order to get us where we need to be.

Have you had any conversations or has that risen as an issue for your organization?

Mr. OATES. Energy questions have come up in our organization. We are mostly a public infrastructure organization and deal with investments there. I am a transportation engineer, so I don't know a lot about a whole lot of the other infrastructure issues.

One of the issues could be that it is more difficult for Congress to get spending in those areas because a lot of that is controlled

by private companies that deal with the infrastructure for energy. So I can't answer a whole lot.

Ms. CLARKE. I am just thinking, construction costs right now skyrocketing. A lot of that has to do with labor, but it also has to do with energy. Right?

So maybe, Dr. Zandi, do you have any ideas about the fact that our energy costs are sort of the companion? It is like the shadow, like that extra piece that is hanging off in everything that we are talking about here, whether it is the cost of food, whether it is the cost of products. It is just sort of hanging off and we are kind of ignoring it. We are talking about it but we are kind of playing footsie with it, but it is costing us.

Do you have any ideas about how the public can partner to jettison us to deal with this? Because I think that that is probably one of the pieces that helps us in the long run. It is the new industry that creates wealth.

Mr. ZANDI. We are talking about energy specifically?

Ms. CLARKE. Energy specifically.

Mr. ZANDI. I think here the solution to our energy problems are long term.

Ms. CLARKE. They are.

Mr. ZANDI. There is very little you can do in the very short run. I mentioned the gas tax holiday. I think that takes some of the edge off for some of the folks, but that is very modest and doesn't solve our long-term problems. With respect to long-term energy, really what policy should be focused on is supply, and that is I do support expanding offshore drilling. I think that makes perfect sense.

By the way, you don't need to see oil wells dug to affect the current price because as soon as the markets sense this is going to happen, prices will come down to reflect that.

Ms. CLARKE. Mr. Zandi, I don't want to take you into one particular industry; what I am talking about is innovation. There are going to be a whole host of different types of production of energy for us. If we don't do that then we are doing a disservice to his 10-year-old son and 3-year-old daughter because we are talking about the long term, and everything that we are talking about today has that as part of the equation. And while people keep saying it is long term, it is now and it is long term. If we don't start, because we are doing little pieces, the snippets that you are talking about, right, it still remains a part of the equation that we have yet to address?

So I think that part of the equation, and I am winding down, Madam Chair, is that we have to make incremental steps as we try to solve the immediate, to come to that point where we have reached the tipping point for the development of new industry in energy. If we don't, we will wake up 10 years from now and the same challenge that we are facing in terms of how we make things happen will continue to exist.

So in terms of the economics of that equation, I think we have to have a wider view of each step that we are taking for our economy and what the shadow that is cast by the energy costs involved has done in every sector of our lives.

Thank you very much, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Chabot.

Mr. CHABOT. Thank you. I will be brief, Madam Chair. This has been a very interesting discussion. Dr. Zandi just said something that I just wanted to point out and just emphasize a little bit. I would agree with the gentlelady that this is a long-term problem that we have here, and it would be good if we could work this out together in a bipartisan manner. We do too little of that in Congress, but this is one we really ought to work on together, and perhaps the rest of the Congress should look to this Committee because the chairwoman has worked over the last year and a half in a very bipartisan manner, and I commend her for that.

Doctor, you just mentioned that if, for example, we announced that we are going to drill offshore or in ANWR, or wherever, where we know that there are significant quantities of energy available to us that we have essentially put off limits, that you would see that essentially directly affect the price because the markets would know that we are serious about this. We are actually going there to get this, even though we may not see that oil for some years. That is why some have argued we are not going to see it for 3 years, 5, 10, so why do we have to do this now. That is why I think we should have done it 3 years, 45 years, 10 years ago, and voted consistently to do that. But that is the past.

As this point, as you indicated, it would be reflected immediately in the markets because of speculation. This is something the Republican leadership pooh-poohed. They said speculation. I agree with the Democrats. I think that is part of it, not the whole thing, but part of it. And so that is why it is so important that we act sooner rather than later to actually announce we are doing this. Even if we don't see that oil, we will see it reflected in the prices very quickly in the downside because of the speculative part of that. Is that correct?

Mr. ZANDI. Let me just point out the conduit through which this would reflect current price maybe as another conduit. You have global energy prices that feel like prices are going to be higher in the future, therefore you are going to keep more oil in the ground today because you are going to get a much higher price down the road. So if they sense there is going to be new supplies coming on and the price may not be higher, they will be much more forthcoming with supplies today and it will bring current prices down.

Mr. CHABOT. Again, I just want to reiterate what I said before. Even though I and many talk about increasing supply now, drilling in ANWR, Outer Continental Shelf, that is only part. We clearly have to emphasize increased technologies of the future, whether it is wind, solar, biomass, geothermal. All those things are part of this picture as well, as well as making it possible to build new oil refineries in this country, which we haven't done in over 30 years. It needs to be a comprehensive energy policy, and again, I wish this Committee was in charge of it because I bet we could solve it in about a week through the great work of Chairwoman Velázquez.

Chairwoman VELÁZQUEZ. On this issue I am not that sure. But let me just say, Dr. Zandi, that look, we all support drilling, and what we are saying is that there are a bunch of oil companies today that are holding leases in about 68 million acres of land and

they are not drilling it. And we are saying use it or leave it. We are going to take it away.

So you mentioned that probably those companies are speculating about oil prices going up and that might be the reason why where they can drill today they are not doing it. So without a single new lease or single new drilling authorization, we can get 4.8 million barrels of oil a day in this country without going into ANWR.

But that is not the question today. That was the statement of the day.

Mr. ZANDI. I think this is an energy policy debate.

Chairwoman VELÁZQUEZ. Yes. Sometimes it doesn't matter the topic, we end up talking about ANWR. So we have got to have ready our talking points.

About the holiday, the pay tax holiday that you mention as being part of the second stimulus package, there are some critics that maintain that while employees could see immediate relief, employers could be burdened by administrative challenges. It is their concern that small firms will face compliance issues and that this could potentially minimize the benefits.

Mr. ZANDI. Excellent point. That is the single most significant negative of that particular proposal. You have to turn the switch on and off. For many, particularly small businesses, they don't have a payroll company that is managing their affairs. If they don't do it right, they will get penalized, although you might construct a legislation so they don't over a period of time.

The other downside is companies more than likely will try to figure out ways to include compensation that they would pay out at some other point in that period so that they wouldn't have to withhold payroll tax. So I am not saying there is no downside. There are. That clearly is, in my view, the most significant downside, the administrative costs, particularly to small businesses. But if you ask them would you want the cash in exchange for a little bit of administrative difficulty, I bet they would take the cash.

Chairwoman VELÁZQUEZ. Ms. Bernstein, I would like to hear your comments.

Ms. BERNSTEIN. I agree with what Dr. Zandi has just said. The larger employers use outside service providers, and I know there are certain payroll companies that can handle this. This is an issue that we looked at a little bit when we were looking at what type of consumer rebate would work, whether it could be a check or whether it would be faster to get the rebate payment to consumers by actually doing it through employer withholding. So it is a similar issue.

I am a little more concerned, as Dr. Zandi said, about the small businesses that don't necessarily use those same outside payroll providers and that there might be more of a burden. But, remember, on the small business side, the self-employed person pays payroll tax twice, so it probably is a significant benefit for a small business person who pays as the employer and as the employee. And so it is possible that they might be able to get more access to more of the software that is out there, and perhaps if it was widespread enough the costs could be minimized.

The question is how long would that take; what would be the start-up time? If you wanted to turn this on more quickly, it might be more of a burden.

Chairwoman VELÁZQUEZ. Dr. Zandi, in your testimony on page 5 you provided "fiscal economic bang for the buck." You have the payroll tax holiday at 1.29; across-the-board tax cut, 1.03; accelerated depreciation .27.

So as we discussed before, our budget is limited, and when we are considering a second stimulus package, we have got to be targeted, we have got to be specific. We need to know. One of the many things that we are going to be considering is going to have the most positive impact in terms of our economy.

How do you come up with these numbers?

Mr. ZANDI. It is based on a simulation of a macro econometric model that I constructed for the purposes of doing this kind of an evaluation. I did it a number of times. I did it in preparation for the 2001 stimulus plan and updated it for the January-February period for the most recent stimulus plan. I have a much more detailed document. I would be happy to describe it.

Chairwoman VELÁZQUEZ. It really caught my attention.

Mr. Connelly, this is my last question. In the housing bill that we passed yesterday, you saw what we did, the Federal Government, regarding Bear Stearns, now Freddie Mac, Fannie Mae. You represent small banks. What will you say will be an action taken by Congress that could prove beneficial for small banks to continue the great work that you are doing?

Mr. CONNELLY. Well, I think the improvement to the FHA programs, GSE reform, temporary FHA program, are all great things. There is a critical thing I want to mention though, and that is we need to recall the lessons that we have learned from the previous rounds of economic weakness. Coming from New England, I recall the real estate debacle of the early nineties and a lot of problems that caused small businesses to be squeezed out of business as a result of performing/nonperforming loans. Just this weekend I heard from some of my colleagues around the country that regulators are beginning to ask for appraisals on performing loans, and it is important that we not force currently performing loans into a distressed condition by making such requests.

So I think we really want to be careful on the regulatory side that we not add fuel to the fire. Those lessons that we learned 5, 10, 20 years ago are so critically important to bear in mind.

Chairwoman VELÁZQUEZ. Again, let me take this opportunity to thank you all. This has been an insightful discussion. As we move forward in terms of having discussions along the leadership regarding a second stimulus package, I promise you that the discussion that we had today will prove beneficial in my input in those meetings where I meet to discuss with the Democratic leadership what we are going to do next. Hopefully, I will be there at the table representing the voice of small businesses in this country. Thank you very much.

Mr. CHABOT. I am sure Nancy Pelosi will care a lot what I thought about the issue, too.

[The statement of Mr. Cochetti can be found in the appendix at page 57.]

[Whereupon, at 11:43 a.m., the Committee was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

STEVE CHABOT, OHIO
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2301 Rayburn House Office Building
Washington, DC 20515-6515

STATEMENT

Of the Honorable Nydia M. Velazquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: *"The Impact of the Economic Stimulus Package on Small
Businesses"*
July 24, 2008

Even in a free-market economy, certain conditions call for swift and sweeping government action. This February-- in the face of rising unemployment and an escalating housing crisis-- Congress took just that. In an overwhelmingly bipartisan effort, we passed this year's most critical piece of financial legislation. The Economic Stimulus Act of 2008 was a landmark bill, and has helped to stem the affects of what has since become a full blown recession.

As of today, 130 million American families have collected stimulus checks. Meanwhile, the country's 26.8 million small businesses have enjoyed significant tax write-offs for investments. All together, these incentives accounted for a \$152 billion shot to the lagging economy.

The stimulus package was more than a band-aid resolution--it succeeded in blunting the effects of what would have otherwise been a crippling downturn. The individual rebates, for example, drove a spike in consumer spending. By late May, retail sales had climbed 1 percent, and early indicators show that they continued to rise in June. In fact, many retailers reported gains of 4.3 percent. These trends were especially helpful to small businesses, which tend to be the largest beneficiaries of consumer spending.

The stimulus package did more than just incentive consumers. It also galvanized small businesses by promising instant write-offs and tax breaks on purchases. In doing so, this particular inducement has done more than just encourage small business commerce. It has the potential to put cash back in the pockets of our entrepreneurs.

These rebates have done a great deal to bolster our struggling financial market. And yet despite their many benefits, the economy still has a long way to go. Rising inflation and climbing unemployment rates have dampened this spring's financial uptick, and we are

now facing a perfect storm of financial crises. But as today's hearing will show, this is not about looking backward, but forward.

In addressing our economic woes, we must focus on ways to stimulate our small businesses. After all, they make up 99 percent of American enterprise, employ more than half of the country's workforce and are the backbone of our economy.

A framework that draws on a combination of tax incentives and targeted investment would allow small firms to build off of the first stimulus package. Several proposals have been suggested for accomplishing this. These ideas include a second round of stimulus checks, increased infrastructure spending and a payroll tax holiday

In this vein, I plan to introduce a bill later today to address certain tax challenges facing small firms. The Small Businesses Tax Modernization and Stimulus Act of 2008 will update outmoded tax codes, thereby correcting many of the inequities currently facing small firms.

While looking for ways to stimulate our small businesses, it is important to search for solutions that have both long and short term effects. Infrastructure spending, for example, would promise a little of both. Not only would it give an immediate boost, but it would also set us up for a series of returns down the road.

We now know that the first stimulus package created a foundation for economic turnaround. Today, we will look at ways to build on that framework. As we move forward, we want to make certain that we provide maximum opportunity for our small businesses to grow. In past recessions, entrepreneurs have succeeded in bringing our economy back on track. This time around promises to be no different.

I'm pleased that today's witnesses could join us for this important discussion, and look forward to their testimony. With that, I now yield to Ranking Member Chabot for his opening statement.

**Opening Statement of
Ranking Member Steve Chabot
House Committee on Small Business
Hearing: Economic Stimulus for Small Business:
A Look Back and Assessing Need for Additional Relief*
July 24, 2008**

Madam Chairwoman, thank you for holding this hearing on the role that small businesses play in supporting our economy. I'd like to welcome our distinguished panel of experts, who have taken time from their busy schedules to provide us with their views. A special welcome to Bill Myles from Cincinnati, who I will introduce later.

Madam Chairwoman, small businesses, like all Americans, are concerned about the slowing growth of the economy. Energy prices are high, the stock market is lagging, people are losing their homes and the U.S. dollar has weakened. Small businesses have been particularly hard hit by this confluence of factors.

We need a comprehensive approach to stem rising energy prices, create more jobs and strengthen our economy. First, we should increase domestic oil production, invest in renewable fuels, and increase incentives for energy efficiency and new technologies. I strongly believe the most critical step toward reducing the price at the pump is boosting domestic oil production – by opening Alaska's Arctic National Wildlife Refuge (ANWR) and the outer continental shelf to environmentally responsible energy exploration. Until we can further develop cost-effective alternative energy solutions, we need more domestic oil production to help lower gas prices and move toward energy independence.

Second, we need to make the 2001 and 2003 tax cuts permanent. These cuts included an across-the-board tax cut for all working Americans, which is especially helpful to small businesses since most file as individuals. In addition, this relief increased the child deduction, raised the student loan interest deduction and eliminated the death tax. Taxpayers will face the biggest tax increase in history if these provisions expire.

The Chairwoman has called a number of hearings on health care, and I think we share a concern about the high cost of, and access to, health care. I believe we should continue to try to find innovative ways to make health care more affordable and accessible for small businesses.

Finally, we must eliminate wasteful federal spending. Our nation's long term fiscal health depends on cutting spending and working toward a balanced budget. The Congressional Budget Office estimates that for the first three quarters of 2008, the federal government incurred a budget deficit of \$268 billion, more than twice the deficit recorded for the same period last year.

These steps would help all Americans, and especially our nation's small businesses, through our challenging economic environment. I thank the Chairwoman for holding this hearing, and I look forward to hearing the testimony.

Statement of Rep. Jason Altmire
Committee on Small Business Hearing
“Economic Stimulus for Small Business: A Look
Back and Assessing Need for Additional Relief”
July 24, 2008

Thank you, Chairwoman Velazquez, for holding this hearing today about the economic stimulus package and the effects it has had on small businesses. In June, the U.S. Department of Labor reported that the national unemployment rate was at 5.5 percent, which was up from 4.9 percent in January 2008. The increasing unemployment rate highlights a growing concern about the economy. A recent Rockefeller Foundation/Time magazine poll found that 47 percent of Americans are concerned about their economic situations, including increasing concerns about losing their jobs. With small businesses creating 80 percent of the new jobs in our economy, economic downturns hit these businesses more significantly.

The economic stimulus package that was signed into law earlier in the year focused on rebate checks that provided citizens with additional money to help boost the economy. Now that all of the stimulus checks have been distributed, it is important for us to evaluate how the economic stimulus package affected consumer spending, as well as small businesses and consider these observations as we try figure out what the next step should be.

Thank you again, Madam Chair, for holding this hearing. I look forward to hearing from our panel today and the suggestions and observations they have regarding the economic stimulus package and how Congress should move forward.

I yield back the balance of my time.

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Testimony of Arthur R. Connelly

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Committee on Small Business

United States House of Representatives



**Testimony of Arthur R. Connelly
On Behalf of the
American Bankers Association
Before the
Committee on Small Business
United States House of Representatives
July 24, 2008**

Madame Chairwoman and members of the Committee, my name is Arthur R. Connelly. I am Chairman of South Shore Savings Bank in Weymouth, Massachusetts, and Chairman-Elect of the American Bankers Association (ABA). South Shore Bank is a mutual savings bank with \$950 million in assets and has served our community for 175 years. I am pleased to be here today on behalf of ABA. ABA brings together banks of all sizes and charters into one association, and works to enhance the competitiveness of the nation's banking industry and to strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

This hearing is very timely. Our nation is certainly facing difficult economic conditions. However, I want to say at the outset that I am, and my banking colleagues across this country are, very bullish about our nation's economic future. We have gone through these periods before and have emerged much stronger as a result. This is not to minimize the problems and dislocations that are occurring today, whether they are from job losses, struggles to stay in homes to avoid foreclosure, or simply the endeavor to meet daily needs in the face of high gas and food prices. It will clearly take time to work through these problems, perhaps even several years. We cannot ignore the current struggles and we need to collectively look for solutions that will ensure a fast recovery. I have always believed that we must be realistic about the present and hopeful for the future. Hearings like this allow us to discuss these issues, work together to restore consumer confidence, and underscore the fact that the heart of our economy is still strong and the overall health of the country will return and be even stronger.

The banking industry continues to work with our customers and our bank regulators to help resolve financial problems as quickly and judiciously as possible. We applaud the efforts of

Congress to find solutions, particularly the modernization of the Federal Housing Administration (FHA) lending authority, the reform of the regulation of Government Sponsored Enterprises (Fannie Mae and Freddie Mac), and the temporary program to utilize FHA to assist distressed borrowers. The Housing package moving through Congress will be another tool for lenders to help borrowers, which should have a positive impact on the overall economy.

The focus of this committee on small businesses is particularly important, as consistently they are drivers of new ideas, new employment, and new economic growth. While some might think of the banking industry as composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, the Small Business Administration defines a small business as one that has fewer than 500 employees. By this measure, over 8,100 banks – 97 percent of the industry – would be classified as small businesses. Even more telling, over 3,500 banks (41 percent) have *fewer than 30 employees*. Even at nearly \$1 billion in assets, my community bank has only 170 employees. Banks like mine have been an integral part of our communities for decades – sometimes more than a century – and we intend to be there for many more to come.

Before turning to my main points, I know that many committee members may be wondering about the health of the banking industry in light of the recent failure of IndyMac. This well-publicized failure – and the subsequent acknowledgment that there will be more bank failures due to bad loans – has focused headlines and lead news stories intensely on the banking industry. Let me assure you that the industry as a whole remains fundamentally strong. Banks entered this current period with a very strong capital position and have continued to build capital over the last several quarters. In fact, the industry added \$13.5 billion to capital in the first quarter – which increased the total capital in the industry to well over \$1.3 trillion – and banks have set aside an additional \$121 billion in reserves as a safeguard against possible losses. Moreover, 99 percent of banks are classified by the regulators as “well-capitalized,” the highest designation given by the banking regulators. Simply put, the industry has the capital and reserves to continue to make the loans that are so vital to our communities. I can tell you that my bank employees are reiterating this fact in all of our communications with customers including our small business customers – as we are making sure that their financial needs are being met.

In my statement today, I'd like to cover three topics:

- Current economic weaknesses will take many months to resolve, but our country will emerge even stronger in the future.
- The process of economic adjustment is well underway, helped by Federal Reserve action and the economic stimulus package. Congressional actions – including improvements to the FHA program, the reform of GSEs, and the temporary FHA program to assist distressed borrowers – should also provide helpful tools.
- Several additional measures would help small businesses, but care must be taken not to enact policies or regulations that will create unintended consequences, including further restricting the availability of credit that is so vital to our economic recovery.

I. Current economic weaknesses will take many months to resolve, but our country will emerge even stronger in the future

The U.S. is in the midst of the most challenging economic period since the recession of 1990-1991. While the dislocations and problems were substantial then as they are today, one important lesson from the 1990-91 experience is that the economy emerges with a strong base capable of supporting long-term economic growth. Indeed, according to the National Bureau of Economic Research, following March of 1991 there was 120 months of economic expansion, the longest period of prosperity since tracking began in 1854.

What makes our current *national* economic circumstances so difficult to discuss is that there are such dramatic *regional* differences in economic performance. States such as Michigan, Indiana, and Ohio are suffering fundamental economic problems, which are largely tied to the fortunes (or misfortunes) of the auto industry. Stagnant job markets and net population out-migration have increased vacancies and pushed prices down. The housing downturn in the last year has only added to the problems already being felt in those and other surrounding states.

Housing problems have led some states into a broader economic downturn. California, Nevada, Arizona, and Florida led the nation in rapidly appreciating home values from 2002 through 2006. All these states had 10-15 percent increases in home prices from 2002-2006, surpassing the national average of 9 percent, and have now witnessed the most dramatic declines in values since last summer. These states, together with Michigan, Indiana and Ohio, account for about half of the foreclosures nationwide.

Other areas of the country, including Texas, Utah, Montana and parts of the Northeast and Northwest, continue to show growth. Businesses involved in exports and food and energy continue to do quite well, and in fact the exports sector played a major role in preventing the U.S. economy from officially entering a recession. Due to restrictions on development, the Boston market did not experience the speculative frenzy experienced in many other parts of the country. While the region experienced declining home prices, these declines were moderate when compared to certain other parts of the country. Although foreclosures have been at record levels due to subprime and other high risk loan products, most in-state banks in the region have not experienced a large increase in delinquencies; these have been concentrated in the out-of-state companies that were aggressive in subprime lending and alternative loan products.

This seems to be the story nationwide. With adjustable subprime mortgages resetting to higher rates and with falling home values in many states and metropolitan areas, delinquencies and foreclosures have increased dramatically. Delinquencies on home equity loans and lines of credit, as well as for autos and other categories of consumer loans, have also risen over the last six months. With slow income growth, falling home equity and stock values, as well as rising costs of food and gas, it is unlikely that we will see delinquency rates fall this year. The most important determinant of consumer delinquencies is job loss. Thus, anything that will stimulate new jobs is likely to have an important influence on economic conditions.

II. The process of economic adjustment is underway

Fortunately, there are signs that the process of adjustment, while slow and often painful, is already underway. There is no silver bullet that will make this happen faster or avoid the strains that many people may suffer. However, there are several positive actions that are already helping.

The action by the Federal Reserve to lower interest rates in the last year has had profound effects. The low interest rate environment (the target Federal Funds Rate has been at 2 percent

since April 30) has reduced the interest rate shock faced by many subprime borrowers with adjustable rate mortgages. Moreover, the interest rate reduction by the Fed reduces the prime rate, which is the standard benchmark for business loans. This has already had the effect of lowering the cost of servicing existing debt for many businesses and lowering the cost of new loans. Moreover, the Fed's interest rate reductions also have meant that rates have fallen for adjustable rate loans such as home equity line and adjustable rate credit cards. New loan rates have fallen on fixed rate loans as well. For example, the interest rate on auto loans fell from 7.77 percent in 2007 to 6.81 percent in May 2008, and the rate on credit cards fell from 13.38 percent in 2007 to 11.87 percent as of May 2008, according to the Fed's most recent Consumer Credit report.

The economic stimulus checks were well timed, and they provided some relief in the face of rising food and gas prices. Also in the stimulus package, allowing small businesses to expense capital investments will stimulate spending in plant and equipment.

The housing market, which has suffered the most, is showing signs that it is improving. At South Shore Savings Bank, residential loan originations for the first six months of 2008 are over 24 percent higher than for the same period in 2007. Our bank competitors voice similar experience, although across the nation housing starts continue to decline. The decline in starts has reduced inventory, which has consequently become much more affordable. This may help to clear further inventory over the summer.

In spite of the housing market problems, lending for individuals and businesses is expected to continue. The National Federation of Independent Businesses (NFIB) commented that businesses are reporting no sign of credit stress. For South Shore Savings Bank, the volume of closed small business lending for the period January – June is up 40 percent compared to the same time last year. The ABA Economic Advisory Committee forecast consumer lending to increase by 4.5 percent and business loans by 7.8 percent for next year.

Lenders are actively working with borrowers who are having difficulty making their mortgage payments. In the second half of 2007, HOPE NOW reported helping an estimated 869,000 mortgage holders through assisting with a repayment plan (652,000) or a loan modification (217,000). This is a difficult and often slow process, and, while many people are being helped, all options are not available to all homeowners. The expansion of the FHA funding (including the FHA Secure Refinancing program) is also helping to stabilize the housing markets.

ABA's Economic Advisory Committee (EAC) expects housing starts and home sales to reach their low point within six months and then improve next year. While the home price

correction is nearly complete in many markets, further price declines, particularly major metropolitan markets in California, Nevada and Florida, are expected next year.

III. Additional measures would help small businesses, but care must be taken not to enact policies or regulations that will create unintended consequences

As I mentioned in the beginning, banks are bullish about our nation's economic future and have continued to invest in local communities. As small businesses themselves, there are several measures that would help banks to carry out this investment, providing further liquidity and capital investment at a time when it is much needed.

Subchapter S status should be expanded

One way to encourage new capital in the banking system is to allow banks to have alternative business structures. One of these is Subchapter S, which allows pass-through income tax treatment and limited corporate liability. Congress made Subchapter S available to insured depository institutions for the first time in 1996. However, at that time many existing banking institutions were unable to make the election because a corporation was not eligible if it had more than 75 shareholders. Legislative changes in 2004, 2005, and 2007 made significant improvements to Subchapter S, enhancing the viability of the structure for banking institutions. ABA supports further improvements that will: (1) increase the number of eligible shareholders to at least 150; (2) clarify that a current law reduction in the amount of deductions a regular corporation can claim with respect to tax-exempt obligations will not apply to a bank after it has been a Subchapter S corporation for three years; and (3) permit IRAs to make new investments in Subchapter S Corporations. ABA supports H.R. 4840, which would modernize the Subchapter S structure, and we encourage Congress to enact it.

Banks incorporating as LLCs should be recognized by the IRS

Another corporate structure that can be useful for banks is a Limited Liability Company (LLC). This structure allows partnership pass-through and corporate limited liability, similar to an S corporation, but allows for increased flexibility to allocate income or losses to different investors. Unlike an S corporation, there are no restrictions on the size and classes of members, so an LLC can be formed quite quickly. Since 1995, the IRS has failed to recognize the tax status of bank LLCs on the federal level. The IRS has maintained this stance even as many states passed laws allowing state

chartered banks to be treated as LLCs for state tax purposes. Moreover, the Federal Deposit Insurance Corporation in 2003 issued a rule establishing that banks could qualify for FDIC coverage as LLCs. This month, legislation was introduced in the Senate that would allow state chartered banks to be taxed as Limited Liability Corporations (LLCs) at the federal level. We encourage the introduction of similar legislation in the House of Representatives.

Shareholder thresholds for SEC registration should be increased

Currently, Section 12(g) of the Securities Exchange Act of 1934 requires a company with \$10 million in assets and 500 shareholders to register its securities with the SEC. While the \$10 million dollar asset size measure has twice been increased since Congress enacted Section 12(g) in 1964, the shareholder measure of a public company, has never been updated. Due to the way assets are measured in the bank, ninety-nine percent of banks meet the \$10 million asset test and, thus, the only criterion of importance to the banking industry is the shareholder measure of a public company. Once labeled as a public company and required to register with the SEC, a company is subject to significant reporting obligations which impose disproportionately high financial and opportunity costs on smaller public companies—costs that are ultimately borne by the company's shareholders and the nation as a whole as the job and economic creativity of small businesses are unnecessarily burdened.

On March 31, 2008, the American Bankers Association NASDAQ index (ABAQ), was comprised of 493 banking companies with a combined market capitalization of \$144 billion. Each year as many as 50 banks choose to delist, triggered primarily by efforts to reduce the burden of the reporting requirements. At a time when the outsourcing of jobs overseas is becoming more and more common among large corporations, small companies such as community banks continue to be job incubators on main street America. It is high time that the 500-shareholder threshold is increased to be a more accurate indicator of a public company. Making this change will restore the principals of proportionality and balance to our securities laws so that the benefits to the investing public outweigh the regulatory costs to our nations' small businesses.

Securitization rules should be studied before they are modified

Securitization is an important funding mechanism for our financial systems, bringing outside investment and liquidity to banks of all sizes. It has revolutionized the capacity of lenders to build capital and offer credit, and has significantly lowered the cost of credit for borrowers. The

Financial Accounting Standards Board (FASB) is currently working to finalize changes in securitization accounting rules in 2008. This rush by FASB to finalize rules by year-end could result in creating more problems than the effort is attempting to solve, discouraging securitizations. This would detrimentally impact lenders of all sorts, especially banks, as securitizations provide a significant market for consumer loans and other credits. If that market dries up further, banks may find that they do not have the necessary funding to continue to provide affordable credit to consumers. ABA recommends a thorough and complete discussion of any potential changes in securitization accounting rules to ensure that we avoid any unintended consequences.

Efforts to increase the covered bond market should be encouraged

Just this month, the FDIC took a significant action to promote a market for covered bonds in the United States, a goal shared with the U.S. Treasury Department. A covered bond market could provide a significant long-term funding source (complementing other funding sources, such as short-term Federal Home Loan Bank advances) to help U.S. banks fund consumer mortgages. Covered bonds are general obligation bonds of the issuing bank secured by a pledge of loans. Unlike other securitizations, the loans backing the bonds remain on the bank's balance sheet. While the European markets for covered bonds is well developed, with an estimated \$2.75 trillion of bonds currently outstanding, the U.S. market is significantly less so due to investor uncertainty regarding how these bonds would be treated in the event the issuing bank failed. The FDIC's recent action makes clear that, under certain conditions, the FDIC will grant investors access to the collateral supporting the covered bonds within 10 business days after the bank fails. While the FDIC's action is a first and important step in the development of the covered bond market in the U.S., the action taken generally benefits the larger lending institutions. ABA recommends that the Congress and the FDIC take further steps to explore methods for allowing community bank participation in this market.

Fair value measurement rules should reflect intrinsic value

ABA believes that the accounting model used to value assets should reflect the business model of the reporting entity. FASB believes that full fair value for financial instruments is the most relevant basis; however, recent accounting rules on how to measure fair value may have brought some unintended consequences and contributed to the current credit and liquidity issues in the marketplace. This is due to the downward impact of those valuations and the pro-cyclical nature of valuation and liquidity. This pro-cyclicality is present in both upward and downward moving

markets, neither of which is helpful in establishing accurate and appropriate prices. In an up market, the fair value rules, as promulgated by FASB, contribute to over-inflation of prices and underpricing of risk. In a down market, the exact opposite occurs.

As an example, if one institution, due to liquidity issues, is required to dispose of an asset at an unnaturally low price to improve liquidity in the short-term, other institutions are subsequently **required to mark their own securities** to reflect the new lower price point set by the distressed institution. As the pricing of assets degrades, yet another institution finds itself in a situation where it needs to quickly sell assets. This then causes prices to erode further, accelerating the decline in liquidity, and around and around we go. This circle of impairment is self-perpetuating, despite the fact that the asset is performing (e.g., payments are current). ABA recommends a correction to the current fair value measurement rules, which currently fail to reflect intrinsic values or provide accurate and useful values to users of financial statements.

SBA programs should be simplified and fees should be lowered

Former SBA Administrator Steven Preston recently noted that volume is decreasing in its flagship 7(a) loan guarantee program. South Shore Savings Bank's experience bears that out. For SBA calendar year 2007, nearly 20 percent of our C&I loans were closed with an SBA guaranty; volume is significantly down this year. No one could argue that the economy is playing a significant role in overall loan volume and dollar decreases, but many lenders and some members of Congress are beginning to wonder whether the SBA programs are becoming too costly and difficult for lenders and the small businesses who wish to access the program. One issue is fees. While no lender would question the need for proper oversight, SBA is now requiring 7(a) lenders to pay SBA fees to cover the costs of conducting an on-site review. The amount of the fee will vary, but as an example of the size of the fee, a \$160 million community bank based in California recently received an examination letter indicating that their fee would be just over \$19,000, plus travel expenses.

Another issue is the complicated process that both banks and businesses have to go through to apply for loans. Right now the procedures manual is 400 pages long. Believe it or not, that is less than half its former size; clearly, great strides have been made. However, progress needs to continue in order to attract lenders and bring this program to more small businesses. Now is the time to make this process easier and cheaper for small businesses and the banks who serve them.



AMERICAN COUNCIL OF ENGINEERING COMPANIES

**Testimony of David M. Oates
President
Oates Associates
Before the House Committee on Small Business
July 24, 2008**

Madame Chairwoman and Members of the Committee,

I appreciate the opportunity to testify before you today about the importance of a safe and efficient transportation system to our economy and the role that transportation and infrastructure investments play in promoting economic growth.

My name is David Oates, and I am the President of Oates Associates, a civil and structural engineering firm in the St. Louis metropolitan area. Our firm offers services from concept through construction, including surveys, civil and structural design, and construction administration for state and local highway and bridge projects, municipal utility and drainage projects, and major state institutional construction. Oates Associates currently employs 40 civil and structural engineers and surveyors.

I am also an active member of the American Council of Engineering Companies (ACEC), the voice of America's engineering industry. ACEC's 5,700 member firms employ more than 400,000 engineers, architects, land surveyors, and other professionals, responsible for more than \$400 billion of private and public works annually. I currently serve as chair of ACEC's Transportation Committee, which develops Council positions on legislation and promotes transportation infrastructure issues before Congress, executive agencies and states.

On behalf of myself and ACEC, I urge you to include spending on our nation's transportation and environmental infrastructure as you consider legislation to stimulate the faltering economy. At a minimum, Congress must do something to address the impending shortfall of revenues in the Highway Trust Fund. I recognize that this matter is not within the purview of this committee, but I would be remiss if I failed to remind you that your state highway programs are facing a 34% cut next year unless Congress acts to maintain the guarantees made in SAFETEA-LU in 2005.

But, much more can and should be done beyond a short-term fix to the Highway Trust Fund. Additional spending on infrastructure – from roads and bridges to sewer and drinking water systems – will provide a near-term boost to the economy through job creation and at the same time provide long-term benefits to our economy.

In conclusion, we are indeed facing a difficult economic cycle, but it's one from which we believe the U.S. economy will emerge strong. Banks, as always, will provide a helping hand in our communities, utilizing all of the tools we have available to us. The above ideas may help expand our arsenal of tools or the reach that some of our tools have. However, as Congress considers these and other changes, we urge caution. Care must be taken not to enact policies or regulations that will create unintended consequences, especially ones that may restrict the availability of credit that is so vital to our economic recovery.

My firm is involved in all manner of public works projects, but my passion and expertise lie in the transportation field, so I will direct the majority of my comments to those matters. Transportation and transportation-related industries account for 10 percent of U.S. Gross Domestic Product, and there is well-documented evidence of the direct correlation between transportation spending and job creation. One commonly cited study found 47,500 jobs associated with \$1 billion in infrastructure spending. My firm, and others in the transportation engineering and construction industry, supports well-paying engineering and construction jobs, the kind of professions that are essential in the increasingly competitive global marketplace. The projected shortfall in the Highway Trust Fund that I referenced earlier could lead to the loss of as many as 380,000 jobs. This is certainly not the direction this economy and this nation need to be taking. We should be putting Americans to work by providing the funding necessary to move transportation maintenance and improvement projects forward.

Additional spending on infrastructure will foster immediate job creation, but it is also important to appreciate the long-term benefits to our national economic competitiveness. Indeed, job creation is a supplemental benefit of the federal surface transportation program, but the primary purpose is the safe and efficient movement of people and goods, which contributes to economic growth by facilitating just-in-time manufacturing and delivery, making personal and business travel easier, and reducing congestion and maintenance costs.

A safe and efficient transportation network is critical to economic growth – it reduces travel time and increases reliability, thus lowering costs and leading to greater economic productivity for businesses and ease of mobility for travelers. As outlined in a 2002 report published by the Transportation Research Board, transportation investment also strengthens local, regional and state economies by energizing city centers and facilitating employment opportunities. One study found that a 10% increase in travel speed leads to a 15-18% increase in the size of the labor market. Transportation improvements also generate additional tax revenue by allowing businesses to expand operations and hire more workers.

Inadequate funding for transportation has led to deterioration, congestion and delays, all of which raise the price of doing business through maintenance and repair needs, wasted fuel and delayed cargo shipments. Last year, our national economy was crippled by nearly \$80 billion in congestion costs. On the safety side, traffic accidents and fatalities, beyond their personal impact, exact a \$230 billion annual toll in economic costs. We must not continue to put lives at risk or diminish our global competitiveness by failing to maintain and improve our transportation network.

According to the National Cooperative Highway Research Program, there is a \$58 billion gap between current expenditures and the cost just to maintain highway and transit performance. To make improvements to the system, that gap grows to \$119 billion. The National Surface Transportation Policy and Revenue Study Commission reports an oft-cited \$225 billion minimum annual investment needed to upgrade our system to a state of good repair and create a more advanced, sustainable system.

The massive quantity of transportation and infrastructure needs are certainly not going to be met in one piece of legislation. But, the American Association of State Highway Transportation

Officials has identified over 3,000 ready-to-go projects that would be sped up through additional, near-term spending. An influx of additional funding would allow state DOTs to move forward with projects that are currently on hold due to uncertainty in funding availability and would free up resources to pursue critical expansion and improvement projects.

In my state, the Department of Transportation has estimated that 20 highway projects at a cost of \$800 million could be built in the next construction season, if additional funding is provided. When factoring in rail, transit, and airport projects, the Illinois list grows to 200 ready-to-go projects in need of about \$2 billion in funding. On the local level, our firm has a number of projects that could be ready to bid in the next few months, just if the Surface Transportation Project budget was increased.

On the environmental side, the need is no less great. Over the next 20 years, America's water and wastewater systems face a funding gap of \$300 to \$500 billion between current annual investments in water infrastructure and the investments that will be needed each year to repair deteriorating water and wastewater systems and meet the mandates of the Clean Water Act and the Safe Drinking Water Act. New solutions are needed to address this gap, as federal contributions to water and wastewater infrastructure have fallen substantially in recent years. For example, funding for the EPA's Clean Water State Revolving Fund (SRF) program – one of the federal government's primary funding programs for water infrastructure projects – has declined steadily over the years from its traditional level of \$1.35 billion. This continuing decline in investment in our nation's water infrastructure further jeopardizes the quality, safety and security of our water. Wastewater treatment plants prevent billions of tons of pollutants from reaching rivers, lakes, and coastlines, protecting human health and benefitting segments of the economy that depend on clean, healthy water resources.

America's water systems contribute to the productivity of the workforce, the quality of the environment, the continuous growth in our GDP, and our standard of living. And like the transportation sector, water infrastructure projects also provide a needed short-term stimulus for job creation. The National Association of Clean Water Agencies, representing over 300 public wastewater treatment agencies, has identified a list of ready-to-go wastewater projects in communities around the country that could benefit from an immediate influx of spending.

By boosting infrastructure spending, you can take an important step toward cleaning up lakes and rivers, bringing quality water into people's homes, fixing structurally deficient bridges, rebuilding crumbling roads and highways, adding capacity to reduce congestion, improving roadways and transit systems to enhance the safe and efficient movement of people and goods around the country. And, the best part is that these are truly investments – we are building structures that will last and will provide added value for years and years. There is both short-term stimulus and long-term gain.

On behalf of ACEC and the nation's engineering industry, I want to thank this committee once again for focusing attention on this important issue. We strongly urge you and the Congress to take up stimulus legislation as soon as possible that includes funding for our nation's highways, bridges, sewers and other areas of critical infrastructure. I would be happy to answer any questions.



Statement
Of
Rachelle Bernstein
Vice President, Tax Counsel
National Retail Federation

**Economic Stimulus for Small Business: A Look Back and
Assessing Need for Additional Relief**
Before the
House Small Business Committee
Thursday, July 24, 2008

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I am Rachelle Bernstein, Vice President and Tax Counsel for the National Retail Federation which is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees - about one in five American workers - and 2007 sales of \$4.5 trillion. Most retailers are small businesses - 96% of retail companies have only one location.

Chairwoman Velazquez, Ranking Member Chabot, and Members of the Committee, NRF commends you for holding this important hearing to evaluate the impact on small business of the economic stimulus package enacted earlier this year and assess the need for additional relief.

Economic Impact of Tax Rebate Payments

Early this year, Congress and the Administration worked together in a bipartisan fashion to enact economic stimulus legislation to aid a slowing economy. The NRF commends the Congress for its quick action to address the nation's economic needs. Because consumer spending represents 70% of GDP, we believe that the tax rebate payments were particularly important. Today, we would like to share with the Committee what we have learned to date about the impact of these tax rebates.

In the current economy, most categories of merchandise and most types of retail outlets are struggling to achieve even modest sales increases. Tax rebate payments are providing some stimulus, but consumer spending remains subdued because of the stresses of declining home values, escalating fuel and food costs, increasing unemployment and weak financial markets.

Consumers are concentrating their spending on essentials. They are also more concerned than ever with pricing of merchandise. Consumers are shopping more on line so that they can more easily make price comparisons and also save money on gas.

For small retailers, this economic climate is even more difficult than for larger retailers. Small retailers tend to compete more on service than on price. Because small retailers cannot benefit from economies of scale, they are hit harder than other merchants by rising costs, particularly the rising cost of fuel. Small retailers who do not sell their goods on line are not be able to take advantage of the shift to online sales.

Direct deposits of tax rebate payments began the last few days of April, followed by the mailing of rebate checks through July 11 for all eligible taxpayers who filed a tax return. After a decline in retail sales in March, there has been a bump in retail sales of general merchandise¹ for April, May and June, which we attribute to the distribution of the tax rebate checks.

The April bump in retail sales was .6 percent seasonally adjusted month-to-month, which was the largest month-to-month increase since November of 2007.

With substantially more checks distributed in the month of May, amounting to more than \$40 billion in rebates, retail industry sales increased by .9 percent on a seasonally adjusted month-to-month basis. Most of the May sales increase went to discounters and grocers, although some shoppers splurged on electronics and appliances.

The Treasury Department distributed almost \$30 billion in rebate checks in the month of June, but consumer spending remained soft, with an increase of .2 percent on a seasonally adjusted month-to-month basis. Most of this increase seemed to be focused on necessities.

A survey of consumers' use of tax rebate checks was performed by BIG Research the week of June 3 – 10. As of that date, 45.3% of survey respondents had received their tax rebate payments. 42.9% of respondents said that they used the money to purchase something. However, nearly half the money that was spent went to gas or necessities such as groceries rather than to general merchandise as envisioned when the rebate check program was passed by Congress. 17.1% of respondents said that they saved their money. As a survey released earlier this week demonstrated, respondents who initially saved their rebate money may use it for purchases in upcoming months.

In survey findings released just this week, NRF found that one-fifth of parents nationwide have set aside a portion of their stimulus check for back-to-school purchases. Specifically, parents say they will use some of their tax rebate check to fund electronics, such as computers and cell phones. The survey found that the average family with school-aged children will spend \$594.24 on back-to-school purchases, compared to \$563.49 last year. Total back-to-school spending for Kindergarten through 12th grade this year is estimated to reach \$20.1 billion.

Assessing the Need for Additional Relief

Economic forces have impacted the consumer over the past few months that were not foreseen when the economic stimulus package was first enacted, particularly the escalating costs of fuel and food. As a result, consumers have

¹ Retail sales of general merchandise exclude automobiles, gas stations and restaurants.

used their rebate money to pay for the higher costs of these items, rather than increasing purchases of consumer goods that would have had a broader impact on the economy. Despite the modest rise in retail sales over the last few months, we believe the results are better than they would have been if Congress had not enacted the tax rebates.

Based on the economic information that is currently available, we believe that a compelling case can be made for providing additional economic stimulus legislation. If Congress does act on a second economic stimulus package, we believe it should once again include relief for the consumer. Since consumer spending is the largest contributor to GDP, it is difficult to foresee an improvement in overall economic growth until consumer spending improves.

AMT

If Congress further delays action on the alternative minimum tax (AMT) there will be negative economic ramifications. Legislation is pending in both Houses of Congress that would extend the so-called AMT "patch" so that 25 million more Americans are not subject to the AMT next year. When Congress delays action on this legislation until the end of the year, as they did last year, it delays the IRS' timing for printing tax forms and processing tax returns. As a result, payments of refunds are delayed. Given the fact that economists predict the economy will still be soft in the first half of next year, receipt of tax refunds will be very helpful to consumers and should not be delayed.

Other Tax Relief for Small Retailers

The NRF has long advocated depreciation reform that will help small retailers. In the 2004 Tax Act, Congress provided a temporary 15-year depreciable life for retailers that lease their property, but continued to require retailers that own their property to depreciate their improvements over 39 years. In many cases, retailers that own their buildings are small businesses, and they are placed at a competitive disadvantage compared with retailers that lease their stores. Furthermore, in the current economic climate, some retailers look at remodeling as a way to revitalize a failing store, but the anticipated return has to pay for the costs involved. When the costs must be written off over 39 years, it is much more difficult to make the decision to remodel the store. We hope that this Committee will support extension of the temporary tax measures that expired at the end of 2007, as well as depreciation reform for retailers. The retail depreciation reform is part of Senate Finance Committee Chairman Baucus' AMT and extenders tax bill, S. 3125, and has been introduced in the House as H.R. 2936 by the Chairman of the Ways and Means Select Revenue Measures Subcommittee, Rep. Richard Neal.

**Written Testimony of Mark Zandi
Chief Economist and Co-Founder
Moody's Economy.com
Before the House Committee on Small Business
Hearing on "Economic Stimulus For Small Business: A Look Back and Assessing
Need For Additional Relief"
Thursday, July 24, 2008**

Mr. Chairman and members of the Committee, my name is Mark Zandi; I am the Chief Economist and Co-founder of Moody's Economy.com.

Moody's Economy.com is an independent subsidiary of the Moody's Corporation. My remarks represent my personal views and do not represent those held or endorsed by Moody's. Moody's Economy.com provides economic and financial data and research to over 500 clients in 50 countries, including the largest commercial and investment banks, insurance companies, financial services firms, mutual funds, manufacturers, utilities, industrial and technology clients, and government at all levels.

I strongly support efforts for a second fiscal stimulus plan designed to help the economy by early 2009. Like the first stimulus plan, it should be temporary and not raise the long-term budget deficit. The plan should also be targeted to help lower and middle income households and smaller businesses that will use the help quickly and aggressively to stimulate the economy.

There are three principal reasons for my support for more fiscal stimulus. First, the economy continues to struggle. Most significantly, employment is falling and unemployment is rising. Over 400,000 payroll jobs have been lost since the beginning of the year and the unemployment rate has risen by more than a percentage points since its low in the spring of 2007.

The job losses have been broad-based across industries and regions of the country. Construction, manufacturing, retailing, transportation, financial services, information services and professional services are all losing jobs. Only health care, educational services and government continue to add to payrolls on a consistent basis.

There are currently nineteen states suffering very weak job markets, characterized by generally falling employment and rising unemployment. These states include Alabama, Arizona, Delaware, California, Idaho, Indiana, Florida, Kentucky, Maine, Michigan, Mississippi, Missouri, Nevada, Ohio, Rhode Island, South Carolina, Tennessee, Wisconsin, and Virginia. Very few states, mostly energy and agriculture-producing economies, are adding significantly to employment.

More job losses are likely in coming months. The housing downturn continues unabated, high energy and food prices are undermining consumer purchasing power, and the financial system remains under significant stress which is

restricting the availability of credit to households and businesses. These economic headwinds are unlikely to abate quickly.

Second, the economic benefits of the first stimulus package passed early this year have been substantial they will fade by year's end. The tax rebate checks mailed between May and early July have provided a substantial lift to retail sales this summer and have been instrumental in offsetting the ill-effects of record gasoline prices. Indeed, the \$100 billion in rebate checks will largely pay for the approximately \$100 billion more consumers will have to pay for gasoline this year. Unfortunately because of the higher cost of gasoline and food, the tax rebates will not be the catalyst for a self-sustaining economic expansion as had been hoped for by policymakers. In fact, retailing is likely to weaken sharply in coming months as the rebate money is spent and the weak job market continues to weigh heavily on consumer purchasing power.

The first stimulus bill also provided business tax incentives to stimulate increased investment. This will provide a small boost to investment spending this year, but the incentives expire at the end of the year and will result in less investment in early 2009.

Third, the need for more fiscal stimulus is reinforced by the already very low interest rates. The Federal Reserve has aggressively lowered interest rates over the past year and with the current 2% federal funds rate target will be constrained from lowering rates

further. Moreover, monetary policy may be less effective in stimulating growth in the current environment. The most immediate conduit between monetary policy and the economy runs through the housing market. Housing is the most interest-rate sensitive sector of the economy, and historically it would receive a quick boost from monetary easing. This boost is much more muted today given the ongoing problems in the private mortgage securities market and at the GSEs. Low interest rates are not helping to increase the availability of mortgage credit.

A second round of fiscal stimulus should include a number of temporary tax and spending items costing between \$50 and \$100 billion. The \$50-\$100 billion in proposed stimulus can also be thought of as making up some of the difference between current consensus expectations for growth in 2009 and the economy's potential growth. According to the Blue Chip survey the consensus is for real GDP to advance by less 2% in 2009. Most economists have not assumed the passage of a fiscal stimulus plan, and most put potential growth at below 3%. If economists are correct about growth next year, then a \$50-\$100 billion stimulus plan would simply put the economy back closer to its trend. If economists are wrong, it's likely they will have erred on the side of optimism, and the economy is already in recession. In that case fiscal stimulus would be especially helpful.

An effective package of stimulus could include a gas tax holiday, expansion of the food stamp program, a payroll tax holiday, aid to state governments,

extension of the investment tax incentives, and increased infrastructure spending. The biggest lift from this stimulus would go to lower income households struggling to pay for soaring gasoline and food prices, and small businesses who are getting hit hardest in the current downturn.

More specifically, extending food stamps are the most effective ways to prime the economy's pump. A \$1 increase in food stamp payments by \$1 boosts GDP by \$1.73 (see table). People who receive these benefits are very hard-pressed and will spend any financial aid they receive within a few weeks. These programs are also already operating, and a benefit increase can be quickly delivered to recipients.

Fiscal Economic Bank for the Buck

One year \$ change in real GDP for a given \$ reduction in federal tax revenue or increase in spending

Tax Cuts	
Non-refundable Lump-Sum Tax Rebate	1.02
Refundable Lump-Sum Tax Rebate	1.26
Temporary Tax Cuts	
Payroll Tax Holiday	1.29
Across the Board Tax Cut	1.03
Accelerated Depreciation	0.27
Permanent Tax Cuts	
Extend Alternative Minimum Tax Patch	0.48
Make Bush Income Tax Cuts Permanent	0.29
Make Dividend and Capital Gains Tax Cuts Permanent	0.37
Cut in Corporate Tax Rate	0.30
Spending Increases	
Extending UI Benefits	1.64
Temporary Increase in Food Stamps	1.73
General Aid to State Governments	1.36
Increased Infrastructure Spending	1.59

Source: Moody's Economy.com

Another economically potent stimulus is aid to financially-pressed state governments. This could take the form of general aid or a temporary increase in the Medicaid matching rate, to help ease the costs of health coverage. Such help appears unlikely in the current stimulus plan, but this could quickly change in coming weeks if the economy's problems grow more severe and widespread as the legislation is being fashioned.

Fiscal problems have already developed in half the nation's states. Tax revenue growth has slowed sharply with flagging retail sales and corporate profits. Income tax receipts are also sure to suffer as the job market weakens. California and Florida are under the most financial pressure, but states as far-flung as Arizona, Minnesota, and Maryland are also struggling.

As most state governments are required by their constitutions to quickly eliminate their deficits, most are already drawing up plans to cut funding for programs ranging from health care to education and cutting grants to local government. Local governments are having their own financial problems; most rely on property-tax revenues, which are slumping with house prices. Cuts in state and local government outlays are sure to become a substantial drag on the economy later this year and into 2009.

On the face of it, increased infrastructure spending appears to be a particularly efficacious way to stimulate the economy. The boost to GDP from a dollar spent on building new bridges and schools is estimated to be a large \$1.59, and who could argue with the need for such infrastructure. The overriding limitation of such spending as a part of a stimulus plan, however, is that it generally takes a substantial amount of time for funds to flow to builders and contractors and into the broader economy (see Table 1). *It should be noted that the economic bang for the buck estimates shown Table 1 measure the change in GDP one-year after the spending actually occurs - it says nothing about how long it may take to cut a check to a builder for a new school.* Many infrastructure projects can take years from planning to completion. Even if the funds are only used to finance projects that are well along in their planning, it is very difficult to know just when the projects will get underway and the money spent. Also complicating the use of infrastructure spending is the politics of apportioning these funds across the country in a logical and efficient way. Despite these caveats, if infrastructure projects can be identified that could be started quickly then this could prove to be an efficacious form of fiscal stimulus.

The U.S. economy will continue to struggle in coming months, but a temporary, targeted, and well-timed second round of fiscal stimulus would go along way to mitigating the severity of the economy's difficulties and perhaps even help jump-start a self-sustaining economic expansion.

Testimony of

William Myles
Vice President of the Western Economic Council
Western Hamilton County, Ohio

Before the United States House of Representatives
Committee on Small Business

July 24, 2008

Re: "Economic Stimulus for Small Business: A Look Back and Assessing Need for
Additional Relief"

Thank you Chairwoman Velazquez, Ranking Member Chabot and all the members of this
Committee for the opportunity to speak today.

The Western Economic Council was founded twenty years ago as a non-profit economic
development group. Today our members represent nearly every aspect of life in the
western suburbs of Cincinnati, Ohio. As members, we voluntarily work to foster a greater
economic and built environment for our region.

In an effort to prepare for this hearing I asked our members a number of questions on the
subject. Much was revealed after several dozen conversations.

Consumer Rebates are being used in every imaginable way.

Recipients I spoke with are, respectively; paying bills, buying gasoline, buying a high
definition television, going on a trip, investing in long term savings, or just putting the
money on the side for a time when they may need it... and everything in between.

Who would argue any payment to consumers is not, in itself, positive for the economy?
An \$1800 check to a family of four with Adjusted Gross Income of \$70,000 is, by any
measure, something of a windfall.

Testimony of William Myles, V.P.
Western Economic Council
Before the U.S. House of Representatives
Committee on Small Business
July 24, 2008
Page 2.

One of our members shared a report of the international shopping centers trade group from earlier this year. It reported their tenants were crediting increased sales to the Consumer Rebates. Last week this same group reported those sales had leveled off and it expects a record number of their tenants will go out of business in 2008.

The anecdotal conclusion of the great majority of those I canvassed is that Consumer Rebates are helpful yet not enough to lift the economy out of a low spot in the business cycle. Rebates may never be reliable at stimulating the economy because they don't guarantee the desired change in behavior. Conversely, tax deductions are inherently reliable.

Generally, our members feel a better short and long term approach is to target benefits to those who have directly invested in the means of production of goods and services.

The owner of a Home Improvement Company hesitated last year to buy additional equipment. This year is a different story. He will hire more people to use this new equipment because of the tax benefits to small businesses. He and others like him will be creating a recurring "\$1800" payment to newly hired workers.

If the goal is to assist those suffering through a particular hardship, such as avoiding home mortgage foreclosure, perhaps specific legislation will be more efficient than broad one time Consumer Rebates as a solution. This was, along with transportation infrastructure improvements, a common alternative to Consumer Rebates suggested by our members.

Perhaps in the fullness of time empirical data will reveal the true impact of The Economic Stimulus Act of 2008. In the meantime, our members value the tax incentives as having a much greater effect on their businesses than Consumer Rebates. And they very much want you to know that continuing the tax incentives to small businesses is critical fuel for what has become the engine of the American economy.

Thank you again, on behalf of all our members.

The Computing Technology Industry Association

**Testimony Before the
House Committee on Small Business**

**"Economic Stimulus for Small Business: A Look Back and
Assessing Need for Additional Relief"**

**Roger J. Cochetti
Group Director-U.S. Public Policy
Thursday, July 24, 2008**

Introduction.

My name is Roger J. Cochetti. I am Group Director of U.S. Public Policy for the Computing Technology Industry Association (CompTIA), which represents over 10,000 American member companies.

I want to thank Chairwoman Velázquez and Members of the Committee for holding this important hearing to highlight the contribution of small businesses to the American economy. I also want to thank this Committee for its vigilant work in maintaining watch for issues that are important to small businesses. We believe that your efforts to maintain public attention - and importantly, the attention of Congress – on the needs of small businesses are vital to our economic well-being.

As this Committee certainly appreciates, small businesses are the backbone of the American economy. According to the Small Business Administration, over 99% of the 26.8 million American businesses are small businesses with fewer than 500 employees.¹ Further, small businesses:

- Employ about half of all private sector employees.
- Pay more than 45 percent of total U.S. private payroll.

¹ SBA Office of Advocacy estimates based on data from the U.S. Dept. of Commerce, Bureau of the Census, and U.S. Dept. of Labor, Employment and Training Administration.

- Have generated 60 to 80 percent of net new jobs annually over the last decade.
- Supplied 22.8 percent of the total value of federal prime contracts in FY 2006.
- Hire 40 percent of high tech workers (such as scientists, engineers, and computer workers).

Further, small innovative firms produce 13 times more patents per employee than large patenting firms, and their patents are twice as likely as large firm patents to be among the one percent most cited.²

Small businesses are a vital source of the entrepreneurship, creativity, and innovation that keeps our economy globally competitive. And as the U.S. economy faces increasing challenges, it is essential that small business be positioned to find nimble and innovative ways to keep our businesses moving.

CompTIA Overview.

The typical small business does not have an IT department; but relies instead for its IT support upon the services of an important segment of the computer industry referred to as “Value Added Resellers” or VARs. VARs are small system integrators that design, install, and maintain computer systems and networks for other small businesses. An

² U.S. Dept. of Commerce, Bureau of the Census: *Advocacy-funded research by Kathryn Kobe, 2007* (www.sba.gov/advo/research/rs299tot.pdf); *Federal Procurement Data System; Advocacy-funded research by CHI Research, 2003* (www.sba.gov/advo/research/rs225tot.pdf); U.S. Dept. of Labor, Bureau of Labor Statistics, *Current Population Survey*; U.S. Dept. of Commerce, *International Trade Administration*.

estimated 32,000 VARs, most of which are small businesses themselves, sell approximately \$43 billion dollars worth of computer hardware, software, and services annually. This means that over one third of the computer hardware sold in the United States today is sold by VARs.

Madame Chairwoman and members of the Subcommittee, the Computing Technology Industry Association represents the business interests of these VARs. For 25 years, CompTIA has provided research, networking, and partnering opportunities to its over 10,000 member companies. And while we represent nearly every major computer hardware manufacturer and software publisher, nearly 75% of our membership is comprised of American VARs – the small business component of the tech industry. So, we particularly appreciate the opportunity to provide this testimony to this Subcommittee.

As further background, in addition to representing the interests of VARs, CompTIA also works to provide global policy leadership for the IT industry through our headquarters in Chicago and our public policy offices in Washington, Brussels, Hong Kong, and Sao Paulo. For most people in the computer industry, however, CompTIA is best known for the non-policy-related services that it provides to advance industry growth: non-technical standards, industry education, business solutions and our very well known professional IT certifications (such as A+) almost one million of which have been issued to IT workers.

Economic Stimulus Needed for Small Businesses.

Inasmuch as small businesses employ about half of all private sector employees and pay about 45% of the total U.S. private payroll in the country, we cannot significantly strengthen the U.S. economy without addressing the needs of small American businesses:

The health of the American economy is dependent upon the health of the small business sector. Therefore, we must take steps that are specifically designed to strengthen American small businesses.

Small Business Expensing - Section 179. As a representative of many small businesses, we are especially appreciative of the work of this Committee in bringing national attention to taxation issues affecting small businesses. And, on behalf of all CompTIA members, I want to personally thank and congratulate this Committee for its work in recognizing the need for, and benefits of, Section 179 of the Internal Revenue Code, which deals with small business expensing.

Of course, we are very appreciative of the increase of the Section 179 provision to \$250,000 as enacted earlier this year. However, while we are most appreciative of this one-year bump, we ask for your support in making this \$250,000 limitation a permanent part of the tax code. The Section 179 expensing provision is an immediate and real incentive for small businesses to invest in their operations. Further, Section 179 expensing encourages the purchase of technology solutions by small businesses from our members companies – making those small businesses more efficient and thereby further

strengthening America's IT industry. Section 179 expensing is a win-win situation, and we call for the permanent extension of the increased expensing limitation of \$250,000.

3% Withholding on Government Contracts. We understand this hearing concerns the need for additional economic relief for America's small businesses, however, we must note that impending implementation of a hugely negative incentive: the 3% federal income tax withholding on government payments to contractors. As important as identifying needed economic stimulation for small businesses, Congress must similarly attempt to address actions that impose an economic burden to small businesses: Look no further than the impending implementation of the 3% federal income tax withholding on government contract payments. This will drive small businesses out of the government contracting market. Of course, we were encouraged by the passage of legislation this year by the House that would defer implementation by one year. However, we see there is much work to be done in order to rescind this law before its effective date.

As clearly as Section 179 is a needed economic stimulus for small businesses, withdrawal of this 3% withholding provision is needed to avoid economic setbacks for our small businesses. This was bad tax policy when it passed, and it is bad tax policy now.

IT Equipment Depreciation.

We need to encourage businesses to become more technology efficient, and therefore, more economically successful. Typically, under generally accepted accounting

principles, an asset is written off over its economically useful life, and historically, the depreciable life of an asset has been linked to this economic life. For computers, the allowable tax recovery period has been set at 5 years. However, with the constant evolution of technology, we have increasingly noted that this 5-year recovery period is no longer reflective of the economically useful life of today's computer. Accordingly, CompTIA calls for the tax recovery period for computers to be reduced to 3 years for all small businesses:

- A 3-year recovery period more closely reflects the actual economic life of today's IT equipment. While a computer can certainly operate longer than 3-years, businesses that do not reinvest in current technology are left at a competitive disadvantage as compared to those businesses that purchase up to date IT equipment.
- It is important to the American economy that small businesses maintain their ability to compete with both small and large businesses; this greatly contributes to the vitality of our economy. A 3-year recovery period will encourage and assist small businesses to sustain this competition.
- A 3-year recovery period for IT equipment will have substantial positive impacts upon U.S. economic growth: Both from the perspective of IT production (which will increase) and also from the perspective of small business IT users (which will have more money for business reinvestment).

As stated earlier, our economy is dependent upon the health of the small business sector, and this – along with the need for fundamental fairness in assessing the lifetime of computer equipment – is why we support a reduction in the tax depreciation recovery period for IT equipment from 5 years to 3 years for small businesses.

Conclusion.

Small businesses are the backbone of the American economy. And while America's VARs continue to provide unique goods and services to American small businesses in general, they also provide jobs to the majority of working Americans. Small business needs your support and we think these are three important ways to express it.

Thank you for your vigilance in assuring that small businesses lead the way in strengthening America's economy.

