FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2010

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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JO ANN EMERSON, Missouri
JOHN ABNEY CULBERSON, Texas
MARK STEVEN KIRK, Illinois
ANDER CRENSHAW, Florida

NOTE: Under Committee Rules, Mr. Obey, as Chairman of the Full Committee, and Mr. Lewis, as Ranking Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

DAVID REICH, BOB BONNER, LEE PRICE,
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COMMITTEE ON APPROPRIATIONS

DAVID R. OBEY, Wisconsin, *Chairman*

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2010

TUESDAY, MAY 19, 2009.

INTERNAL REVENUE SERVICE

WITNESS

DOUGLAS SHULMAN, COMMISSIONER OF INTERNAL REVENUE

Mr. SERRANO. The subcommittee will come to order. Good morning to all. Today the subcommittee meets to discuss the Internal Revenue Service and its budget request for fiscal year 2010.

The IRS is by far the largest budgetary item within the subcommittee's jurisdiction, and the administration's budget request for the IRS for fiscal year 2012 is $12.1 billion, an increase of $603 million, or 5.2 percent, above 2009.

We welcome the Commissioner of Internal Revenue, Douglas Shulman, back for his second appearance before our subcommittee, 2 for 2.

As we all know, the IRS helps collect 96 percent of the Federal Government's revenue, helping to ensure funding for every important government function imaginable. Each year the IRS processes more than 140 million tax returns. The IRS assists millions of taxpayers each year over the phone, at walk-in sites, and via the IRS Web site. The IRS does all of this while continuing its Business Systems Modernization program to modernize the information technology systems that make all of this possible.

The issue of the tax gap; that is, the difference between the amount of taxes owed and the amount actually collected, has grown in prominence in recent years. The most recent estimate of the tax gap is $290 billion, which the IRS Taxpayer Advocate has described as a surtax of more than $2,022 per taxpayer to subsidize the noncompliance of others.

I am pleased that the administration has put forward a plan to hire additional IRS enforcement personnel to pursue, for example, individuals seeking to avoid U.S. taxes by parking cash overseas. At the same time, the Taxpayer Advocate has noted the recession has brought increased hardship to a great many taxpayers of more modest means, rendering many unable to pay overdue tax debts.

The balance between these two priorities, closing the tax gap while at the same time exploring special accommodations for taxpayers facing economic hardship, is an ongoing issue with the IRS.

We also would like to continue to emphasize my strong support for expanding IRS efforts to provide quality services for taxpayers. As noted in last year's IRS progress report on the Taxpayer Assistance Blueprint, a portion of the tax gap is attributable to errors by individual taxpayers, errors that IRS service programs should be designed to prevent and correct. While volunteer organizations have done terrific work in providing free or low cost assistance to taxpayers all across the country, volunteers alone cannot be expected to provide these important services.

The importance of IRS services and the continued high demand for such services is particularly illustrated by the experience of the IRS toll free hotline last year. Because the IRS received a higher than expected volume of phone calls with questions related to the 2008 economic stimulus checks, the IRS did not have the capacity to assist millions of taxpayers in a timely manner, though the Commissioner and the IRS are to be commended for making every accommodation to assist as many taxpayers as possible.

Commissioner Shulman has served as IRS Commissioner since March of last year. Prior to that he served as Vice Chairman of the Financial Industry Regulatory Authority. Earlier in his career, he served as Senior Policy Advisor and Chief of Staff to the National Commission on Restructuring the IRS.

Commissioner Shulman, thank you very much for your service, and we very much look forward to your testimony and to discussing the challenges faced by the IRS. And while my opening statement does seem critical of some of the work, I know that you are really trying to turn this agency around.

It is just that there are two agencies in this country that bring fear into the hearts of people. One is IRS and in some neighborhoods it is I-C-E, ICE, the immigration department, and the IRS. And both at times have had a reputation for being a little rough on folks. And so in our desire to balance things out, we know that you play a major role, and our private conversations have shown that to me. So I stand ready to assist you in every way possible and ready to listen to your testimony today.

And now I turn to a woman who is obviously allergic to the IRS.

Mrs. EMERSON. Or something.

Mr. SERRANO. Or something. My colleague and my friend and my sister, the ranking member, Ms. Jo Ann Emerson.

Mrs. EMERSON. I thank you. I seem to have gotten an allergy once I walked in this room. Thanks so much for being here, Commissioner Shulman. I really appreciate it, and I appreciate the hard work that you are doing in getting things turned around at the IRS. I believe, too, that fairness in our tax administration is critical.

Back in February the IRS Oversight Board released a survey indicating that 89 percent of those asked think it is not at all acceptable to cheat on their taxes, the highest level ever recorded for this question on the survey.

The tax gap is estimated to be $290 billion, and this undermines the idea that everyone is paying their fair share. The budget request proposes an enforcement increase of $332 million to address this gap. While I support increased enforcement efforts, I don't believe that you can eliminate the tax gap through enforcement alone. The tax system is very complex and IRS needs to provide sufficient services to the public to help honest taxpayers file their taxes correctly.

I do agree with the vast majority of Americans that it is not at all acceptable to cheat on your taxes, and I will work very hard to ensure you have the necessary resources to educate consumers on how to comply and have the necessary resources to identify those who haven't paid their fair share.

With the fiscal 2009 deficit approaching $2 trillion in deficit spending, expected to continue for the foreseeable future, it is real obvious that effective tax administration is critical. So we recognize that you are leading the IRS during very challenging times.

I am grateful for your service. I am sure it is not fun when people say, hey, what do you do? And you say I run IRS. As my dear friend Joe Serrano said, it is one of the most, or at least it used to be, one of the most feared agencies. But once people meet you, I don't know how they can fear you because I think that you are really doing a very good job and appreciate so much the work of you, Commissioner, as well as 100,000 IRS employees around the country.

We look forward to hearing your testimony.

Mr. SERRANO. Thank you. Please, we always ask that you keep your testimony to 5 minutes, the whole statement will go in the record, and this will give us time to grill you to a point where you will resign and leave. Only kidding, don't get nervous. Please proceed.

OPENING STATEMENT OF COMMISSIONER SHULMAN

Mr. SHULMAN. Thank you, Chairman Serrano, Ranking Member Emerson. I appreciate the kind words of support, and I appreciate all the support this Committee has given me, and the time the two of you personally have spent learning about the agency and supporting us.

I appreciate the opportunity to appear today to talk about the President's fiscal year 2010 budget request for the Internal Revenue Service. Over the past year I think that the agency has demonstrated both performance improvements, as well as the ability to be agile and respond quickly to rapidly changing situations, particularly the economic downturn.

This budget, the goal of this budget, is to build on our strategic foundations and invest in the Nation's tax system. The IRS, and I have talked to both of you about this, must excel at both service and enforcement. It is not an either/or proposition. This budget will help us to continue along the path of continuous improvement around service and enforcement, along with the critical underpinnings of those, which are technology and our workforce.

The budget requests an increase of $332 million for investments in compliance programs. This includes a robust portfolio of enforcement for the International Enforcement Initiative that the President, Treasury Secretary, and I unveiled on May 4th. I have made international issues a top priority of the IRS, and this budget will give us unprecedented tools, resources, and people to make sure the overall coverage in that area is appropriate.

We also know that increased resources for compliance programs have a direct return on investment. I think that is incredibly important in a difficult budget situation and with the deficits we have. The initiatives that we have asked for will account for $2 billion a year of direct additional revenue once they are fully implemented in a couple of years, once we staff up and get the programs in place. That doesn't take into account the indirect revenue effects. When people know that the IRS is watching certain behaviors, it also increases voluntary compliance.

We have also asked for significant resources to make sure that we have quality and effective taxpayer service, and we are looking for support for our in person, our telephone, and our Web based tools for service. We think this is incredibly important with a voluntary tax system, making sure that when people come to the IRS they get their questions answered. Getting their issues resolved is just as important to us as bringing in the $2.5 trillion that it takes to run this country and as enforcement programs.

I am also pleased to report that I think this agency has really stepped up in implementing the American Recovery and Reinvestment Act, known as the stimulus program or the Recovery Act. This budget gives us continued resources to implement that vital piece of recovery for the economy.

Let me talk for one minute about the modernization of our core account database. I believe that the IRS has consistently delivered over the last several years and proven that it can run technology programs. This year alone 40 million taxpayers were processed through a modern database.

We have adopted what I think is a much more focused strategy going forward. We have gradually shifted course from simultaneously developing a database and the software applications that plug into that database to a very streamlined focus on completing the database first and then working on the applications a step behind. I think it is going to be an accomplishment in itself to have all the taxpayer accounts on a modernized database. It will also position the IRS well for future online services and new compliance and enforcement systems.

Let me mention two more things. One is efficiency. This budget reflects efficiency savings from increased electronic filing and other innovations that we have put in place. Just for electronic filing, this budget accounts for a 5-year savings of $100 million. So ramping down some of the processing sites to account for more electronic filing.

And finally, I would ask you to pay some attention to the legislative proposals that are in our budget, which complement the direct expenditures. Three that I will mention quickly: one is there is a suite of offshore tax evasion proposals that will be very important to us executing our mission. Two, there is a proposal to require tax preparers who have a certain volume of tax return filings to file electronically. This is quite important to us. And three is a proposal that we drop the down payment requirement when you are applying for an offer in compromise with the IRS, which is someone coming in who is usually in a hardship situation. Right now you have to put down a 20 percent down payment, which we think can discourage people from using offers in compromise. We have a legislative proposal to drop that, to increase the use of this program.

So Mr. Chairman and Ranking Member Emerson, thank you, again, for allowing me this opportunity to testify. I very much urge the passage of this budget. It is going to give us the tools we need to provide high quality taxpayer service, as well as a robust enforcement portfolio, and also to invest in our technology and our people, which are key underpinnings. I am happy to answer any questions that you have.

[The statement of Mr. Shulman follows:]

**WRITTEN TESTIMONY OF
DOUGLAS SHULMAN
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON
FY 2010 IRS BUDGET
MAY 19, 2009**

Introduction

Chairman Serrano, Ranking Member Emerson, and Members of the Subcommittee, thank you for the opportunity to appear today to discuss the President's FY 2010 Budget request for the Internal Revenue Service. I want to thank the Administration for this strategic and wise investment in the nation's tax system that will help the IRS stay on a path of continuous improvement in such critical areas as service, enforcement, technology, and human capital.

Through its service delivery, the IRS is often the face of government to the American people. The IRS is the only agency that interacts with every business, every taxpaying individual, and every non-profit organization each year. We have that rare opportunity to influence how people think about their government.

In terms of service, I believe that taxpayers want to come to the IRS, get their questions answered and issues resolved quickly, and be on their way. It sounds simple, but in a time of increasing complexity of the tax law, and challenging economic circumstances, achieving this goal will require discipline, focus, and resources. Our service operations must be designed with the taxpayer experience as the ultimate measure of our success.

We also need a vigorous and effective enforcement program. In today's tough economic environment, it is more important than ever that every citizen feels confident that individuals and corporations are paying the taxes they owe.

The American people who play by the rules every day expect the IRS to pursue those taxpayers who do not pay their taxes, and we are vigorously enforcing the tax law. We are focusing on current enforcement initiatives, such as in the international arena, while seeking to evolve and innovate. We can also hone our enforcement techniques by adding new tools, such as more information reporting, soft notices, and self-correction.

Of course, all of our efforts depend upon the people of the IRS. We must ensure that we have talented and capable leaders and employees for the foreseeable future at the IRS, and that they have the tools and resources they need to succeed.

Finally, we need to continue moving our technology to the next level. The tax system, America's taxpayers, and the approximately $2.5 trillion of revenue depend on it.

A Firm Foundation Upon Which to Build

The IRS has a firm foundation upon which to build. Let me briefly highlight some key trends that demonstrate both across-the-board performance improvements and the IRS' ability to be agile and respond quickly to changing situations.

Service

As of May 9th, for the 2009 filing season, the IRS has received 132.2 million total individual returns and has issued 102.3 million refunds, for a total of $273.5 billion. A record 91.2 million tax returns were electronically filed this year – a major milestone for the IRS and testament to our commitment to a robust electronic tax administration program. So far this filing season, the e-filing rate is almost 70 percent for individuals, as compared to 61 percent for the same time period last year.

This year, there was also a surge in e-file from home computers. More than 31 million people prepared their own e-file return, representing more than a 19 percent increase from the previous year. And there were almost 200 million visits to IRS.gov, comparable to last year.

And almost 200 million people IRS.gov continues to exhibit remarkable growth with almost 191 million visits to the IRS Web site this year, up from about 168 million as compared to the same period last year – a more than 13 percent increase.

Taxpayers could also find on the IRS Web site the latest information about the American Recovery and Reinvestment Act (ARRA), including details on extending health insurance for people who lost their jobs and tax breaks for first-time homebuyers. In addition, the IRS has developed "What If" scenarios and the possible tax implications for people who may be facing financially difficult times.

American Recovery and Reinvestment Act

The Internal Revenue Service is proud of the role it has played, and will continue to play in helping to implement, provide guidance, and publicize many of the provisions of the ARRA that will assist both individuals and businesses in economic distress and is getting the Nation back on the road to economic recovery.

For example, a mere four days after President Barack Obama signed ARRA into law, the Treasury Department and the IRS swung into action in record time, developing new withholding tables to ensure money would get into American's pockets through the Make Work Pay Credit.

In March, the IRS announced that businesses with deductions exceeding their income in 2008 can use a new net operating loss tax provision to get an expedited refund of taxes paid in prior years. This provision could throw a lifeline to struggling businesses, providing them with a quick infusion of cash. We are also making it as easy as possible for businesses large and small to take advantage of these benefits.

We have shifted resources to deal with the expected growth of bankruptcies and business workouts. Moreover, we worked with the Treasury Department on a number of regulations that clarified rules to unclog the credit markets.

On the individual front, we have taken a broad approach. Through a series of massive, nation-wide outreach efforts, such as "Super Saturday," we wanted to make sure that even more taxpayers are aware of every credit, deduction, and exclusion for which they qualify, including several new benefits this year.

Our message to taxpayers was that we are going the extra mile to help those in economic distress. We want to get them their refunds as quickly as possible. And if they think they can't pay, we ask them to come in and talk about it. There are steps we can take to help.

The bottom line is that we need to be flexible, principled, and empower our employees to use their judgment when dealing with these taxpayers in areas such as missed payments and postponing collection actions.

This year there are also a variety of new benefits and tax credits the IRS is administering that can also help energize the economy and generate much needed jobs. We are working with the media and other stakeholder groups to get out the message about their availability.

Enforcement

In FY 2008, both the levels of individual returns examined and coverage rates rose substantially. We conducted nearly 1.4 million examinations of individual tax returns in FY 2008, an 8 percent increase over FY 2006. This reflects a steady and sustained growth over the past three years. Similarly, the audit coverage rate has risen from 0.58 percent in FY 2001 to 1.01 percent in FY 2008.

While the growth in examinations of individual returns is visible in all income categories, it is most apparent in examinations of individuals with incomes over $200,000. Audits of these individuals increased from 105,549 in FY 2007 to 130,751 during FY 2008, an increase of 24 percent. Their coverage rate has risen from 2.68 percent in FY 2007 to 2.94 percent in FY 2008.

In the business arena, audit coverage rates for small corporation returns (assets under $10 million) increased slightly over FY 2007 by .03 percent. Of note, coverage rates for three classes of large corporations with assets between $50 million and $250 million and higher all increased. Coverage rates for partnership returns stayed even as compared to

FY 2007, while Subchapter S returns reflected a small .05 percent drop due largely to the increase in number of S-coroprations. The coverage rate for tax-exempt organizations increased slightly.

IRS Criminal Investigation has also been vigorously attacking egregious tax avoidance, money laundering, and other financial crimes that have a corrosive effect on our tax system. For example, overall number of individuals charged in an information or indictment rose from 2,323 in FY 2007 to 2,547 in FY 2008.

Over the same period of time, prosecution recommendations for employment tax evasion more than doubled. The incarceration rate in these investigations was 81 percent and the average sentence was 29 months.

In FY 2008, IRS-developed cases related to foreign and offshore issues also resulted in 61 criminal convictions, and the average term for those going to jail was 32 months. For the first four months of FY 2009, there were 20 convictions, and the average sentence was 84 months

IRS Workforce

In late FY 2008, the IRS established the *Workforce of Tomorrow* task force to address recruitment and retention issues so that the IRS has the necessary leadership and workforce in place to address future challenges.

The IRS considers employee engagement fundamental to the overall success of the organization and believes that employee engagement is an ongoing process. The IRS conducts an annual survey to assess the level of engagement of employees. Overall satisfaction showed steady improvement from a score of 3.48 in 2002 to a score of 3.79 in 2008, on a scale of 1 to 5, with 5 being the most satisfied.

IRS job satisfaction is higher than most other federal agencies, according to the Office of Personnel Management's Federal Human Capital Survey.

The Administration's FY 2010 Budget Request Funds Key Priorities

Total resources to support IRS activities for FY 2010 are $12,440,801,000. This amount includes $12,126,000,000 from direct appropriations, an estimated $147,101,000 from reimbursable programs, and an estimated $167,700,000 from user fees. The direct appropriation is a $603,402,000 increase, or a 5.2 percent increase over the FY 2009 enacted level of $11,522,598,000. This amount excludes funding to implement the ARRA.

The IRS continues to achieve efficiency savings in its operations. Because of the increase in e-filing, the IRS has effectively revised base operations and continues to implement savings resulting from the consolidation of an additional two of the paper processing sites. This consolidation has already resulted in significant savings and will continue to do so.

The IRS Strategic Plan 2009-2013 guides program and budget decisions and supports the Department of the Treasury Strategic Plan. The IRS Strategic Plan builds on past successes while being innovative and adapting to new situations, such as the increasing complexity of tax laws, changing business models, expanding use of electronic data and related security risks, accelerating growth in international tax activities, and growing human capital challenges. I am a firm believer that organizations must always be evolving, changing, and improving and the strategic plan reflects that philosophy.

The IRS Strategic Plan has two overarching goals: (1) improve service to make voluntary compliance easier; and (2) enforce the law to ensure everyone meets their obligation to pay taxes. The IRS must excel at both service and enforcement to meet its mission; it is not an either-or proposition.

To improve service and make voluntary compliance easier, the FY 2010 President's Budget Request for IRS provides the necessary funding to implement the following key strategic priorities.

Enforcement Program

The FY 2010 President's Budget request includes program increases of $332.2 million for investments in strong compliance programs, including a robust portfolio of international enforcement initiatives that the President and Treasury Secretary Geithner and I unveiled on May 4, 2009.

The international initiatives include reforming business tax deferral rules so that – with the exception of research and experimentation expenses that have significant spillover benefits to the United States – companies cannot receive deductions on their U.S. tax returns supporting their offshore investments until they pay taxes on their offshore profits. The Administration would also seek to prevent abuse of the foreign tax credit.

In addition, getting tough on overseas tax havens is an integral part of the Administration's plan. It would reform the so-called "check-the-box" rules to require certain foreign subsidiaries to be considered as separate corporations for U.S. tax purposes. It would also crack down on the abuse of tax havens by wealthy Americans. For example, the Administration proposes withholding taxes from U.S. customer accounts at foreign institutions doing business with the U.S. but which don't share information with the IRS through the "Qualified Intermediary" program. To further combat abuse, the Administration proposes extending the statute of limitations for international tax enforcement to six years.

The Administration's full budget describes additional international tax reform proposals. Other legislative proposals to improve compliance and strengthen tax administration can be found later in this testimony. A key focus of our strategy is to shift enforcement resources so we can expand programs targeted at non-compliance among large corporations, U.S. business with international operations, high net-worth individuals, flow-through entities and partnerships.

Increased resources for the IRS compliance programs yield direct measurable results through high return-on-investment activities. The new enforcement personnel funded in the FY 2010 President's Budget are expected to generate $2.0 billion in additional annual enforcement revenue once the new hires reach full potential in FY 2012. This estimate does not account for the deterrent effect of IRS enforcement programs, which are conservatively estimated to be at least three times larger than the direct revenue impact.

The tax law is complex, and even sophisticated taxpayers make honest mistakes on their tax returns. Accordingly, helping taxpayers understand their obligations under the tax law is critical to improving compliance. To this end, the IRS remains committed to a balanced program of assisting taxpayers in both understanding the tax law and paying the proper amount of tax.

Taxpayer Service Program

The FY 2010 President's Budget request continues improvements to both the quality and efficiency of taxpayer service, using a variety of person-to-person, telephone, and web-based and self-serve methods to help taxpayers understand their tax obligations and pay what they owe. The IRS taxpayer service program is funded in the Taxpayer Services and Operations Support appropriations. It should be noted that service investments and strategy are guided by the Taxpayer Assistance Blueprint – a five year plan that outlines the steps the IRS should take to improve taxpayer service and the IRS strategic plan.

Providing quality taxpayer service is fundamental to keeping honest taxpayers in the tax system and compliant. It also helps them avoid making unintentional errors before returns are filed, which, in turn, reduces the need for follow-up correspondence from the IRS.

The IRS provides year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.

For example, in the Small Business arena alone, in FY 2008, the IRS participated in over 2,600 meetings, symposiums, and seminars attended by over 162,000 small business owners and tax professionals. The IRS also holds national and local Small Business Forums which provide an open avenue of communication between IRS and trade and industry groups. We held 135 Small Business Forums and facilitated 410 Small Business Tax Workshops in FY 2008.

American Recovery and Reinvestment Act

As noted in the introduction, the IRS is now implementing a number of ARRA tax provisions, including individual tax credits, such as the Make Work Pay credit; energy credits for certain appliances, education credits, and child care credits; tax incentives for business; bond incentives; and a tax credit to provide discounted health benefits to certain workers who have lost their jobs. The IRS will be able to continue to implement and administer these critical tax programs within the levels contained in this Budget request.

Explanation of Budget Activities

Enforcement

The FY 2010 President's Budget request is $5,504,000,000 in direct appropriations and an estimated $60,797,000 from reimbursable programs, plus an estimated $7,800,000 from user fees[1], for a total operating level of $5,572,597,000. The direct appropriations level is an increase of 7.6 percent from the FY 2009 enacted level and includes $600,000,000 to support tax enforcement activities funded by an allocation adjustment. This appropriation funds the following budget activities.

- ***Investigations ($637,694,000 from direct appropriations and an estimated $51,553,000 from reimbursable programs)*** This budget activity funds the criminal investigations programs that explore potential criminal violations of the internal revenue tax laws, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It also includes investigation and prosecution of tax and money laundering violations associated with narcotics organizations.

- ***Exam and Collections ($4,706,350 from direct appropriations, an estimated $8,783,000 from reimbursable programs, and an estimated $7,800,000 from user fees)*** This budget activity funds programs that enforce the tax laws and compliance through examination and collection programs that ensure proper payment and tax reporting. The budget activity also supports appeals and litigation activities associated with exam and collection.

- ***Regulatory ($159,956,000 from direct appropriations and an estimated $461,000 from reimbursable programs)*** This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; advice on general legal servicing, ruling and agreements; enforcement of regulatory rules, laws, and approved business practices; and supporting taxpayers

[1] Note that user fees are available to supplement appropriations contingent on demand for user fee services and receipt of fees. These amounts are subject to change.

in the areas of pre-filing agreements, determination letters, and advance pricing agreements.

The Office of Professional Responsibility is funded within this budget activity and is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

Taxpayer Services

The FY 2010 President's Budget request is $2,269,830,000 in direct appropriations, an estimated $39,000,000 from reimbursable programs, and an estimated $127,000,000 from user fees, for a total operating level of $2,435,830,000. The direct appropriations level is a reduction of 1.0 percent from the FY 2009 enacted level, though it does not represent a program reduction due to non-recurrent activities and savings. This appropriation funds the following budget activities.

- ***Pre-Filing Taxpayer Assistance and Education ($676,063,000 from direct appropriations, an estimated $819,000 from reimbursable programs, and an estimated $18,700,000 from user fees)*** This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

- ***Filing and Account Services ($1,593,767,000 from direct appropriations, an estimated $38,181,000 from reimbursable programs, and an estimated $108,300,000 from user fees)*** This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically-submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods. As previously noted, a record 90 million tax returns were filed electronically this year.

Operations Support

The FY 2010 President's Budget request is $4,082,984,000 in direct appropriations, an estimated $47,304,000 from reimbursable programs, and an estimated $32,900,000 from user fees, for a total operating level of $4,163,188,000. The direct appropriation level is an increase of 5.6 percent from the FY 2009 enacted level and includes $290,000,000 of support funding for enhanced enforcement activities. This appropriation funds the following budget activities.

- ***Infrastructure ($900,852,000 from direct appropriations, an estimated $155,000 from reimbursable programs, and an estimated $16,100,000 from user fees)*** This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-Automated Data Processing (ADP) equipment.

- ***Shared Services and Support ($1,296,629,000 from direct appropriations and an estimated $32,228,000 from reimbursable programs)*** This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

- ***Information Services ($1,885,503,000 from direct appropriations, an estimated $14,921,000 from reimbursable programs, and an estimated $16,800,000 from user fees)*** This budget activity funds staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs. The IRS business programs rely on these systems to process tax and information returns, account for tax revenues collected, send notices for taxes owed, issue refunds, assist in the selection of tax returns for audit, and provide telecommunications services for all business activities including the public's toll-free telephone access to tax information.

Business Systems Modernization (BSM)

The FY 2010 President's Budget request is $253,674,000 in direct appropriations. This amount is an increase of 10.3 percent from the FY 2009 enacted level. This appropriation funds the planning and capital asset acquisition of information technology (IT) to continued modernization of the core taxpayer account database.

This effort is a critical underpinning of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls. This activity also funds the ongoing development of the Modernized e-File platform for filing tax returns electronically. The account also funds BSM labor (salaries and expense dollars) and related contract costs.

Health Insurance Tax Credit Administration (HITCA)

The FY 2010 President's Budget request is $15,512,000 in direct appropriations. This amount is an increase of 0.7 percent from the FY 2009 enacted level. This appropriation funds costs to administer a refundable tax credit for health insurance to qualified individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002 (Public Law 107-210).

FY 2010 Budget Adjustments

The IRS funding increase for FY 2010 is $603,402,000, which includes $256,329,000 for maintaining current levels; a net decrease of $115,794,000 from efficiencies, savings and reinvestments; and a program increase of $462,867,000 to strengthen enforcement, address IT security needs and deploy information technology systems. These investments also fund increased front-line enforcement efforts. By FY 2012, these investments are projected to increase annual enforcement revenue by $2.0 billion.

The budget request supports these activities by proposing:

- $332,160,000 to target the tax gap by addressing underreporting of tax associated with complex international activities; expanding enforcement efforts on noncompliance among business and high-income taxpayers; and minimizing revenue loss by increasing document matching efforts;
- $108,100,000 to address critical IT operational and security infrastructure needs; and
- $22,607,000 to accelerate efforts to modernize the core taxpayer account database.

FY 2009 Enacted Level

The FY 2009 enacted level for the IRS is $11,522,598,000, supporting an estimated 94,209 FTE.

Maintaining Current Levels

- ***Adjustments Necessary to Maintain Current Levels +$260,061,000 / 0 FTE*** Funds are requested for: FY 2010 cost of the January 2009 pay increase of $80,054,000, the proposed January 2010 pay raise of $148,894,000, and non-labor related items such as contracts, travel, supplies, equipment, and GSA rent adjustments of $31,113,000.

- ***Government-wide Reduction for Productivity Improvements -$13,732,000 / 0 FTE*** The IRS continues to focus on improving the efficiency of its operations through a disciplined process of productivity improvement. Additional efficiency savings are outlined in the next section.

- ***GAO Audit Reimbursement Pursuant to Public Law 110-323 +$10,000,000 / 0 FTE*** This estimated adjustment will provide funds to reimburse the Government Accountability Office (GAO) for the audit of the IRS annual financial statements. The IRS must pay this cost pursuant to Public Law 110-323. In prior years, GAO conducted the financial statement audit for which it did not receive reimbursement.

Efficiency Savings

- ***Increase e-File Savings -$8,360,000 / -182 FTE*** This decrease is a result of savings from increased electronic filing (e-File), which is projected to lead to 4.6 million fewer returns filed on paper (2.9 million individual and 1.7 million business) in FY 2010. This is projected to result in a savings of 182 FTE in submission processing.

- ***Non-Recur Savings -$27,074,000 / 0 FTE*** This decrease is the net reduction of one-time costs associated with the IRS FY 2009 enforcement initiatives.

- ***Non-Recur Stimulus Savings -$67,900,000 / -1,322*** **FTE** One-time resources were provided in FY 2009 to meet the requirements of the Economic Stimulus Act of 2008 (Public Law 110-185).

- ***Non-Recur FY 2009 Reduction Adjustment/ Correspondence Inventory -$13,439,000 / 0 FTE*** One-time resources were provided in FY 2009 to handle the increased adjustment/correspondence workload that resulted from diverting staff from paper correspondence to telephone service to meet the requirements of the Economic Stimulus Act of 2008 (Public Law 110-185).

- ***Non-Recur Pension Plan Form Processing -$1,352,000 / 0 FTE*** This decrease results from the funding of the one-time cost in FY 2009 to test the IRS ERISA (Employee Retirement Income Security Act of 1974) Residual Solution (IERS) system. This system will process the electronic Form 5500, *Annual Return/Report of Employee Benefit Plan* from the new Department of Labor ERISA Filing Acceptance system and the paper Form 5500EZ, *Annual Return of One-Participant (Owners and Their Spouses) Retirement.*

Reinvestment

- ***Submission Processing Consolidation (Andover) +$2,331,000 / 0 FTE*** Increased use of electronic filing options has led to consolidation of the individual return processing sites. Increased e-File savings will be reinvested to fund one-time severance pay costs for the ramp-down of the Andover submissions processing site. As the Andover consolidation approaches, the IRS will continue to assist employees in finding employment either in or outside the IRS.

Program Increases

- ***Reduce the Tax Gap Attributable to International Activities +$128,064,000 / +784 FTE*** The IRS plans a multi-year investment, beginning in FY 2010, to deal more effectively with increasing international tax activities of individual and business taxpayers.

  This multi-year investment will improve the identification and coverage of international issues and increase issue specialization to address increasingly complex international transactions by both business and individual taxpayers. It will bring an unprecedented increase in international resources with the specialized skills to identify and examine international non-compliance.

The resources will improve the use of data we receive from non-U.S. entities and foreign governments, provide the needed legal resources, and address aggressive profit allocation activities of multi-national entities doing business in the U.S.

This effort will also focus on increasing reporting compliance of domestic taxpayers with offshore activity. The additional resources will allow the IRS to implement a stronger presence in offshore activities that will be able to uncover the use of offshore credit cards, disguised corporate ownership, brokering activities, and non-U.S. financial institutions providing banking services to U.S. and non-U.S. persons. This initiative will also fund the anticipated growth of collection activities resulting from increases in small and large business examination assessments, foreign investment transactions, and withholding compliance for nonresident aliens.

Finally, this initiative will allow the IRS to increase its overseas presence by adding attachés in key countries to continue our efforts to aggressively combat abusive foreign tax schemes and other tax evasion schemes. These resources are also a key component in supporting the Department of Treasury's objective of "Pre-empted and neutralized threats to the international financial system and enhanced US national security."

This multi-pronged approach will aggressively target the many areas of offshore tax abuse with the goal of identifying more of these abuses and curbing this activity.

- ***Improve Reporting Compliance of Small Business and High Income Taxpayers +$94,215,000 / +755 FTE*** This initiative will improve reporting compliance by increasing examinations of business and high-income returns and exams involving flow-through entities by 47,400; audits targeting employment, excise, and estate and gift taxes by 6,350; and investigations of business non-filers by 183,000. This request will generate $567.2 million in additional enforcement revenue once new hires reach full potential in FY 2012.

- ***Expand Document Matching for Business Taxpayers +$26,237,000 / +300 FTE*** This initiative will increase the coverage of the document matching program to reduce the number of business taxpayers who misreport their income. This request will generate $386.5 million in additional revenue once new hires reach full potential in FY 2012.

- ***Address Nonfiling/Underpayment and Collection Coverage +$83,644,000 / +491 FTE*** With expanded enforcement efforts in recent years, the IRS must invest in improving its collection operations to ensure appropriate overall balance and coverage. This initiative will generate $359.4 million in additional revenue

- ***Address IT Security and Material Weakness +$90,000,000 / +36 FTE*** Improving IT security is necessary to ensure the integrity of the tax system and maintain taxpayer confidence. This initiative will allow the IRS to enhance enterprise security risk management; harden software applications and network infrastructure security; improve security compliance monitoring and reporting; and provide an enterprise solution to deploy end-to-end audit log collection.

- ***Implement Return Review Program (RRP) +$18,100,000 / +10 FTE*** In FY 2008, the Electronic Fraud Detection (EFDS) System stopped $1.4 billion in erroneous refunds. This initiative will complete modernization of the IRS fraudulent refund detection systems. It will deliver an integrated and unified RRP system that will enhance IRS capabilities to detect, resolve, and prevent criminal and civil tax refund and abuse.

- ***Business System Modernization (BSM) +$22,607,000 / 0 FTE*** This initiative will provide funding for the continued modernization of the core taxpayer account database. This effort is a critical underpinning of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls.

Legislative Proposals

The FY 2010 President's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. These proposals will specifically target the tax gap and generate nearly $10 billion over the next ten years. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

- *Modify Electronic Filing Requirements* – Electronic filing benefits taxpayers and promotes effective tax administration because it decreases processing errors, expedites processing and payment of refunds, and allows the IRS to efficiently maintain up-to-date records. This proposal would require electronic filing by tax return preparers (initially defined by a set threshold amount).

- *Expand Information Reporting* – Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would:

    1. Require information reporting on payments to corporations;
    2. Require a certified taxpayer identification number (TIN) from contractors;

3. Require increased information reporting on certain government payments; and
4. Increase information return penalties.

- *Improve Compliance by Businesses* – Improving compliance by businesses of all sizes is as important. Specific proposals to improve compliance by businesses would:

    1. Require electronic filing by certain large organizations; and
    2. Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes.

- *Strengthen Tax Administration* – The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would:

    1. Expand IRS access to information in the National Directory of New Hires for tax administration purposes;
    2. Make repeated willful failure to file a tax return a felony;
    3. Facilitate tax compliance with local jurisdictions;
    4. Extend statutes of limitations where state tax adjustments affect federal tax liability;
    5. Improve the investigative disclosure statute;
    6. Repeal the requirement of a partial payment with an application for an offer-in-compromise; and
    7. Allow assessment of criminal restitution as tax.

- *Expand Penalties* – Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would:

    1. Impose a penalty on failure to comply with electronic filing requirements; and
    2. Clarify that the bad check penalty applies to electronic checks and other forms of payment.

Improve Tax Administration and Other Miscellaneous Proposals

The Administration has put forward additional proposals relating to IRS administrative reforms. These proposals would:

- Require information reporting on expense payments relating to rental property;
- Improve the foreign trust reporting penalty;
- Apply the Federal Payment Levy Program to contractors before providing Collection Due Process; and
- Clarify that vendor levy on "goods and services" would not exclude "property."

Conclusion

Mr. Chairman, thank you again for this opportunity to testify on the President's FY 2010 Budget for the Internal Revenue Service. We urge its passage. It provides the IRS with the much needed resources to provide taxpayers with high quality customer service, and bolster IRS enforcement in critical areas, such as unlawful offshore tax evasion. It also makes wise investments for the next generation of technology and the IRS workforce.

I also urge this Subcommittee to support the enactment of the legislative proposals included in the Budget to improve compliance. Collectively, they will generate more $10 billion over the next 10 years if enacted.

I look forward to working with you and the Subcommittee on this important budget request and I will be happy to respond to any questions.

ELECTRONIC FILING

Mr. SERRANO. Thank you. As you were speaking, something came to mind—I don't know if you mentioned it in your testimony—how many people are now filing electronically? What is the percentage? Do you know?

Mr. SHULMAN. This year we had quite an uptick, we hit the 90 million mark. To date, that amount has been just under 70 percent. People who file extensions, though, a lot of times come in on paper, so we expect that percentage to drop a little bit. But last year we were just around the 60 percent mark. So we have seen a big jump this year.

Mr. SERRANO. Now electronically if you don't have a checking account or a bank account, what can you do using the electronic filing? If you owe, you can still file electronically, right?

Mr. SHULMAN. Right.

Mr. SERRANO. But if you are getting a refund then you have another issue altogether.

Mr. SHULMAN. Yes. The best thing for people to do is file electronically and get direct deposit. In general, we get deposits back in about 5 to 10 days. If you get a paper check, it takes longer. We actually are quite interested, this Administration is interested and we are interested, in the whole issue of the unbanked and people who do not have bank accounts. And we have done some innovative programs around automatic debit cards and ran a pilot with a bank this year around debit cards. We are going to keep exploring that option because we have a problem with a lot of people not being banked and we have a problem with people getting taken, sometimes, using refund anticipation loans. And so we are very interested in electronic filing, getting it in to us, getting it into a bank account, being part of the whole savings mechanism of the whole country.

Mr. SERRANO. I would encourage you to continue to do that. Those loans have been a problem, and I think they will continue to be a problem unless we stay on top of them.

OFFSHORE TAX EVASION

As you know, earlier this month the President announced a major initiative to target businesses and wealthy individuals who avoid U.S. taxes by putting their cash overseas. Part of the $332 million in enforcement initiatives in the budget request would go towards staffing in support of this initiative. My question is, in addition to that, other than the increased appropriation, is there anything else you need from Congress in order to make this initiative work? Because we want it to work. We are considering the amount of money, but in addition to that is there legislation or anything else that you need that has to happen?

Mr. SHULMAN. Yes. First, let me say Secretary Geithner and the President and the whole Administration has been incredibly supportive of our efforts around international tax administration, and it is something that the President brought to the job with him, a real interest in curbing offshore tax abuse.

The proposal that we announced last week had a set of legislative proposals and increased resources for IRS enforcement. The resources we have requested are ones that we think we can prudently put to work, because every time we go and hire new people, we have to take our best people off-line to train them. And so keeping current performance while investing in the future is a challenge. So the resources needed are great.

There is a suite of international proposals that are part of the President's budget, and they were also released in detail in the Treasury Green Book last week. The proposals vary—some are targeted at deferral of expenses. These are much more broad tax policy. There is a set, though, of administrative proposals. For example, we count on the banks who transfer money in and out to be our eyes and ears, and to be good citizens in tax administration. We have a program called the Qualified Intermediary Program, in which people report information about people who are investing in the U.S. or U.S. citizens who have money overseas. There are proposals in there to increase those banks' due diligence, to make sure if you set up a foreign trust that you are actually not a U.S. person. There are pieces in there that make them report their worldwide income, and then there are disincentives for any bank that does not sign up and agree to give us information; there is withholding at the source. Those are critical to our enforcement efforts around individuals.

So that in creating that whole suite of international legislative proposals, the IRS had a seat at the table. I was intimately involved in those and I really encourage the passage of all those. If we don't get, especially, the administrative pieces together with our requested enforcement folks, it is going to be much harder for us to do our job.

Mr. SERRANO. What kind of cooperation do you get from overseas? I mean, is this something that you understand they want to work with you on?

Mr. SHULMAN. Yes. In the business context, sometimes it is a zero sum game. Either one country gets taxes or the others get foreign tax credits. And so there are some debates with what we call the competent authority process. We have a pretty well-defined procedure to work out where someone is paying taxes.

When it comes to individuals, people who are cheating the U.S. Government are usually going to be cheating other governments, and there is a lot of commonality of interest and coordination. Over the last 5 years, we have set up international communication and dialogue forums with foreign tax administrators and us. We have something called JITSIC, which is Joint International Tax Shelter Information Centre, where we collocate people. We have a group of the 10 leading countries' tax administrators get together informally each year, something called the Leeds Castle Group. And we have the Forum on Tax Administration, commissioners from 35 countries.

I believe our international efforts are us doing it alone, us using information better, us coordinating with our partners overseas. And so I am personally quite invested in that coordination. I would say we get good cooperation with most countries. We have a lot of information exchange treaties. The countries with which we don't have good cooperation and don't have treaties, feel a lot of international pressure on them right now through the G–20 and through our enforcement efforts and others.

Mr. SERRANO. Ms. Emerson.

INTERNATIONAL TAX GAP

Mrs. EMERSON. Thank you, Mr. Chairman.

Let me ask a couple more questions if I could on this issue. Of the $3 billion tax gap that exists today, do you know what percentage would be attributable to international tax evasion schemes?

Mr. SHULMAN. We don't. It is very hard to estimate. The tax gap research—just to put it in context—a lot of it is extrapolated numbers from the 1980s and 1990s, and so these are big, broad general numbers. It is generally broken down by corporations, individuals, et cetera. A lot of the international information we get comes from a return with a piece of the return that has an international component and a piece that has a domestic component.

What I will say is there have been some wild estimates thrown out by academics with which we certainly don't agree. People have talked about $100 billion and other numbers. Those numbers are pretty broad numbers that don't have much basis. The way you really get these numbers, in a way that we feel confident talking about, is through random audits of people and corporations that we usually wouldn't do. Usually we do an audit when we think there is an issue. We do random audits to figure out the difference between what those people should have paid but didn't, and go from there. And so there is not a good estimate for the international tax gap.

With that said, with the focus we have put on the international tax gap and with the focus the President has put on it, I have challenged our research team to get creative about quantifying that number.

ENFORCEMENT RETURN ON INVESTMENT

Mrs. EMERSON. Do you have—let me ask this a different way. Do you believe that just through increased discussion of new enforcement mechanisms, if you will, that businesses and individuals will change their behaviors and perhaps be less likely to engage in tax fraud, internationally specifically? But I mean is it enough of a hammer; do we really have to do the legislation to back it up?

Mr. SHULMAN. Well, I think there is clearly direct revenue. We send people out, they bring money in. That is the direct revenue effect. The indirect revenue effect that I was referring to in my oral testimony is really about when people know we are watching certain segments and they become more compliant.

I think for many years some people have felt relatively safe taking these risks, and some financial institutions have marketed, "come hide your assets over here, the IRS won't find them." And so I think we need to back up our words and have a comprehensive program to keep going after and finding people who are hiding assets overseas.

What I will tell you is that it is my belief that during the last year this net is tightening, we are finding more people. We also have a voluntary disclosure program which, if people come in and voluntarily—truly voluntarily, not because they know we are about to knock on their door—they can avoid going to jail, because a lot of these people are criminally evading taxes. We have seen a significant uptick in our voluntary disclosure program. And so I think we are going to need to stay at it. Frankly, us just having more people without some of the legislative pieces that I talked about, like the Qualified Intermediary Program, like withholding at the source if you don't report income, will significantly water down our efforts.

COOPERATION WITH ENTITIES ON ENFORCEMENT

Mrs. EMERSON. Let me ask you one last question with regard to this. Back in February an international bank headquartered overseas entered into a deferred prosecution agreement in which they admitted to helping U.S. taxpayers hide income from you all, the IRS. Tell me what process you used to get that bank to agree to do that so in turn they would end up—you know, as part of the agreement they would end up helping us in the United States identify people who were in fact hiding income?

Mr. SHULMAN. Yes. So first let me just state, any specific taxpayer I can't talk about.

Mrs. EMERSON. Right, right.

Mr. SHULMAN. And the matter you are talking about is one in which the criminal settlement has been done.

Mrs. EMERSON. Right.

Mr. SHULMAN. But there is ongoing civil litigation. So the Justice Department has asked me not to speak specifically about that. But let me talk in broad terms. We have informants who come in. Part of your voluntary disclosure and not going to jail is telling us who your advisers were and others. When we find out there are institutions facilitating or selling offshore tax accounts, we will then go after both individuals who are evading taxes, and institutions that are facilitating them. And we have got a range of tools to do that. We have a very close relationship with the Justice Department. They are committed because this whole Administration is committed to combating offshore tax evasion, and so there are criminal tools. There is settlement potential like you are talking about, and then there is us continuing to pursue the individuals.

I always like to make clear, and my staff reminds me of it often, that there is a lot of leverage going after institutions because you get big swaths of taxpayers. But at the end of the day, it is each citizen's and taxpayer's responsibility to pay their taxes dollars, so we will continue to pursue both.

Mrs. EMERSON. I appreciate that. Thank you, Mr. Chairman.

PARTICIPANTS IN OFFSHORE EVASION

Mr. SERRANO. Another thought comes to mind, I know you can't tell us individuals' names or corporations, but what kind of individual or group hides money overseas to avoid taxes? Is it underworld people, is it individual taxpayers or corporations or all of the above?

Mr. SHULMAN. I would split it up—I think of offshore tax evasion and offshore tax non-compliance in two very distinct categories. One is individuals and one is corporations, and we have different problems and different programs for both of them.

With individuals you have legal source income issues, which is where I make money legally, but then I go hide it overseas and don't pay taxes on it. There is also illegal source income: people who are doing things illegally here and pushing the income overseas. We pursue both, criminally and civilly.

With corporations, I think it is more as the world becomes more globalized, some of the statistics are startling. In 1990 there were 3,000 global multinational corporations in the U.S.; today there are 63,000. And there are a lot of very honest taxpaying citizens and there is a lot of very legal tax planning going on. What I tell people is if you are going to push the envelope, you are usually going to do it where there is complexity. We have seen that in our capital markets, from the world I come from, in some of the derivatives. And you see the same thing in tax administration. And so corporations are pushing intangibles, like patents, overseas. We need to make sure they are allocating the expenses and the income to those. They are doing cost sharing. And people who want to push the envelope and push into gray areas will do it in the international arena and with global capital flows.

And so what we are doing in the corporate arena is making sure we can match the sophisticated lawyers and accountants and advisers that people have, and we are going to try to keep people who are within the gray zone on the right side of the law and not pushing the envelope, to make sure they are not overpaying their taxes, but they are not underpaying their taxes to the U.S.

Mr. SERRANO. Thank you. Ms. Lee.

Ms. LEE. Thank you very much. Good to see you and thank you for being here and thank you for your testimony.

Mr. SHULMAN. Thank you.

EXECUTIVE COMPENSATION AND TAX EQUITY

Ms. LEE. Well, I guess I can say the IRS is really a very, very important entity now within our government in terms of just cracking down on white collar crime, which has been I think allowed to just run amok in the last 8 years. I was on the Financial Services Committee and watched the whole deregulation of the financial services industry take place and also had great concern about the skyrocketing pay of the executives in the financial services sector. And of course many of us believe that it is time now to fix the Tax Code, to stop taxpayer subsidies of these outrageous bonuses and compensation packages.

I want to just mention one bill that I have introduced as a result of this. That is the Income Equity Act, H.R. 1594. What that does is limit the tax deductibility of executive compensation packages that are larger than 25 times the annual pay of the lowest paid worker in the company.

Currently, as you know, companies are allowed to deduct up to $1 million in wage income to pay their top execs, and because of this, noncash executive compensation, which is fully deductible under the Tax Code, has really exploded.

So how do you see the current tax law and how might we address this growth of the executive compensation?

And secondly, do you think that reasonable limits on the deductibility of the highest paid employees would bring some of the most egregious pay packages down to earth? Do you think we need to look at ways to address tax equity at this point?

Mr. SHULMAN. Let me say a couple things about your questions and comments. One is the Treasury Secretary, I know, has been very focused on the dual issues of stabilizing the economy during this tough time for the benefit, ultimately, of taxpayers, including, sometimes, stabilization of the financial services sector, and looking to the future to make sure we have a sustainable economy. I would refer you to the President's budget and the tax proposals that this Administration has submitted to address some of the issues of income inequality and some of the issues concerning the gap that has been growing between the rich and poor in the country.

Clearly the President has, through the Making Work Pay Credit, tried to get money into people's pockets. Where there are limits, it has been to restrict some of the deductions that are taken by higher income individuals. So I think this Administration is trying to get there. I won't comment on executive pay specifically.

Ms. LEE. Sure. I understand that and I believe this administration, the President is moving very assertively in the right direction. I also just for the record, Mr. Chairman, want to say that taxpayers need to recognize that they are subsidizing these huge executive compensation packages by allowing the deductibility by these corporations. I mean that is a direct subsidy. And so hopefully sooner or later we will be able to address this in a very systemic way.

TROUBLED ASSET RELIEF PROGRAM

Let me ask you also with regard to TARP and the TALF initiatives as it relates to the IRS. Are you involved in any of the accountability mechanisms to make sure that these funds which have been sold as assets to any of the Treasury programs, like the commercial paper funding facility, are you, is the IRS involved in any of this monitoring and accountability effort with respect to those funds.

Mr. SHULMAN. Beyond our ongoing work that we do with—you know, every major corporation in the U.S. has ongoing dialogue with the IRS around tax issues. We are not involved specifically in accountability.

Ms. LEE. You are not?

Mr. SHULMAN. That is not part of the mandate.

Ms. LEE. Okay.

Mr. SHULMAN. We are not. Philosophically, the IRS tries to be nonpartisan, and traditionally has been, and this Administration has asked me to be a very nonpartisan, nonpolitical institution. You know, we have TARP recipients, multiple years of lots of different issues, credits and debits on the books. And I instructed our staff to keep doing their job, as they always have, so we have long-term stability in tax administration.

HIRING AND DIVERSITY

Ms. LEE. And diversity in hiring, how are you in terms of your workforce?

Mr. SHULMAN. We are very focused. One of the first things I did was start the Workforce of Tomorrow Task Force. We, like the rest of the Federal Government, have a lot of people eligible to retire, some potential turnover. We have a lot more turnover in the boom times than you have in bust times. We serve every single American and because we serve every American and are the face of the government, we have been very focused on diversity for a long time. I have been very public with our employees. I see having a diverse workforce as far as gender, background, race, et cetera, not as only a requirement, but also as a strategic imperative for us as we serve all the American people.

Ms. LEE. Thank you very much. Thank you, Mr. Chairman. Let me just thank you again, because I know all of our offices have many, many constituents who have IRS cases and you know we appreciate your response to our case work efforts, also.

Mr. SHULMAN. Thank you.

Mr. SERRANO. Yes, we do. Thank you.

Mr. Boyd.

Mr. BOYD. Thank you, Mr. Chairman. Commissioner, thank you for your service.

Mr. SHULMAN. Thank you.

COLLECTION

Mr. BOYD. I know all of us want the fairest tax system and tax administrative agency that we can have. One of the things that makes that difficult is the people that do owe or scam a system or don't pay it and I know there has been a lot of talk about that. I have been really intrigued by this conversation over how you collect some of the debts that people owe, and particularly on the issue of the ones that the IRS and the taxpayer both agree that the taxpayer owes, but because of a lack of resources or lack of technology you are unable to collect those debts, and there has been some attempt in the past to do that in some other ways through the private sector.

I know that there has recently been a decision by the administration to not do that anymore. Can you tell me what the analytical basis for that is and talk a little bit about that and how we might do better?

Mr. SHULMAN. Sure. Look at our whole pipeline. We go out and we look at taxpayers. If they have an adjustment made, we assess more tax, or sometimes they voluntarily come in, but that is just the beginning, Some pay and some don't pay, like any place else, and then we have a collection process. Collection is a big deal to us and it is obviously where the rubber hits the road because in our enforcement efforts, it is where we actually bring cash into the government.

2003 is when this first discussion came up around using private debt collectors versus our people—what makes sense, what doesn't. And back then we had about $7.3 billion of agreed upon debt, which we call potentially collectable inventory. So, that is the inventory of debt to collect that we put on the shelf because we didn't have the resources. If we sent out a collection letter, we needed to make sure we had the necessary service and the phone resources to answer that phone call when someone calls back. As the Chairman said, not everybody is not excited to see the IRS's return address, and so we want to make sure we give them good service when they get to us.

Through our very focused efforts on collection over the last 5 years, we have cut that potentially collectible inventory in half. The analytics around the private debt collectors and why we decided not to renew the contract is, one: we ran an apples-to-apples study of agreed upon debt of a certain size. And we found that on average, we were bringing in three times more dollars for every dollar we spent on our people than spent on the private debt collectors.

Two: in this difficult economic environment, I gave our people a lot more authority to waive debt, put things in the back of the queue, do an offer in compromise. By statute, the private debt collectors didn't have all the tools that our people had. And so I wanted to make sure every taxpayer who was dealing with someone trying to collect their tax debt had the same opportunity for the flexibility of the resources.

And three: this President has made a multiyear commitment to our enforcement efforts.

I do want to make clear this, obviously, became a relatively polarizing and political issue. I made the decision based on analytics. I believe that the private sector individuals doing the job were not abusive; there weren't incentives for abuse, and we could have overseen them just fine. It was really that I thought that the dollars we invested in our people, in our systems, A: would have a greater return; B: that we would get those dollars under this Administration; and C: that taxpayers should all have access to the same options. It is no fault of the private debt collectors. It is by statute. We couldn't give them all the powers of our people, and I figured we should run a uniform collection program.

Mr. BOYD. So it becomes an issue of who will finance the debt collection effort. Are we as a Nation, as an agency willing to do that? We have not—obviously that was part of the problem in the past. We weren't willing to do it and so we went out to the private sector to ask them to do it on some sort of commission basis, I assume. Is that fair? Are you—based on what you said, you sound comfortable that we as a government now are willing to finance that collection effort?

COLLECTION

Mr. SHULMAN. I guess I would phrase it a little bit differently. I would say you need to spend money, regardless, to oversee the program, manage the inventory, kick the inventory back to the IRS when there is an issue a private debt collector can't take care of. And so, I feel comfortable now that we are going to fund even more robust collection and we are going to be able to do our job even better. Even barring that, my analysis is the money we spent on private debt collectors was better spent with us doing the programs.

Again I want to be very clear, I did not participate in the demonization on either side of the issue. At the end of the day, it is because some of the inherently governmental functions that, by statute, the private debt collectors couldn't perform we ended the program. I think running a uniform program so every taxpayer gets a call with somebody who, on the enforcement side, can put a levy on their account, which private debt collectors can't, and on the service side can actually give them relief when they have a real hardship is important. And so philosophically, that is where we landed.

TYPES OF DEBT

Mr. BOYD. Can you quickly review what some of those numbers are, outstanding debts in different categories; for instance, the ones that the taxpayer concedes he owes versus some of the other numbers?

Mr. SHULMAN. Well, I can get you all the numbers, so I don't get them wrong, but let me give you a couple of very relevant facts. One is, by statute, we have to keep debts on our books for 10 years. When you look at all the debt packed on, there is no private sector comparison to a 10-year old debt for somebody who has gone through multiple jobs and gone through bankruptcies; it stays on the books with the IRS. And so some of our numbers are inflated. So when you see our overall numbers, that is not real money that you go and get. Unlike corporations, we can't write it off because we have statutory requirements.

The most relevant number that we track is our potentially collectible inventory, and that is what we determined really could, potentially, be collected. That amount has decreased from 2003. That number was $7.3 billion. It is down to $3.6 billion. In this budget there is money for us to go after some of that debt. And some of it is as simple as using our automatic collection system, where we send out a letter to you. We won't send out letters to people unless we know we can man the phones to answer those questions.

I would be happy to get you all the statistics. I just don't want to get them wrong.

Mr. BOYD. Thank you. Thank you, Mr. Chairman.

[The information follows:]

Potentially Collectible Inventory in Active Collection and Non-Active Collection Status

Dollars in billions	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Total potentially collectible inventory	$ 76.7	$ 79.2	$ 81.3	$ 87.0	$ 95.6	$ 105.3	$ 113.3
Potentially collectible inventory in active collection status:							
Notice	$ 14.3	$ 13.7	$ 15.8	$ 21.1	$ 21.4	$ 22.8	$ 20.7
Telephone (Automated Collection System)	$ 13.3	$ 15.4	$ 14.6	$ 21.5	$ 17.9	$ 19.6	$ 22.1
In-person contact (Collection Field Function)	$ 20.1	$ 21.5	$ 23.4	$ 24.5	$ 32.7	$ 36.9	$ 38.2
Potentially collectible inventory dollars in active collection status	$ 47.7	$ 50.6	$ 53.8	$ 67.1	$ 72.0	$ 79.3	$ 80.9
Percentage of potentially collectible inventory in active collection status	62.2%	63.9%	66.2%	77.1%	75.3%	75.3%	71.4%
Potentially collectible inventory in a non-active collection status:							
Queue	$ 21.5	$ 21.3	$ 20.8	$ 15.0	$ 19.5	$ 22.0	$ 27.8
Shelved due to lack of resources	$ 7.6	$ 7.3	$ 6.7	$ 4.9	$ 4.0	$ 3.5	$ 3.6
Potentially collectible inventory dollars not in active collection status	$ 29.1	$ 28.6	$ 27.5	$ 19.9	$ 23.5	$ 25.5	$ 31.4
Percentage of potentially collectible inventory in non-active collection status	37.9%	36.1%	33.8%	22.9%	24.6%	24.2%	27.7%
Total percentage	100.1%	100.0%	100.0%	100.0%	99.9%	99.5%	99.2%

Mr. SERRANO. Thank you. Mr. Culberson.

COLLECTION

Mr. CULBERSON. Commissioner, thank you very much for coming. Mr. Boyd has already covered the area I really wanted to focus in on. From a personal perspective I have always been a coauthor and supporter of the fair tax. I hope you don't take it personally whenever I talk about we need to I think shift tax collection back to the State level, let them collect retail sales tax, and send that on to the Federal Government. I am a big 10th amendment Jeffersonian. So if I ever talk about putting the IRS out of business, I hope you will forgive me. It is nothing personal.

Mr. SHULMAN. I take very few things personally, especially at the witness table.

Mr. CULBERSON. It is a matter of deep philosophical commitment on my part to try and restore the 10th amendment and get back to what Mr. Jefferson and Madison intended.

Actually you have covered most of areas that I wanted to talk about. So I don't have any questions, Mr. Chairman. Thank you very much.

Mr. SERRANO. That is a first, a historic moment.

STIMULUS AND DECLINES IN CUSTOMER SERVICE

Commissioner, last year the IRS was tasked with helping to administer the stimulus checks in addition to the tax filing season duties. Congress appropriated additional funds for this purpose, and the IRS implemented both the filing season and the stimulus payments successfully, except that the level of service on the IRS 1–800 help line declined from 82 percent in fiscal year 2007 to 53 percent in fiscal year 2008.

In addition, as you know, more than $500 million in enforcement revenue was not collected as a result of the need to shift IRS personnel to customer service related to the stimulus checks. Looking back at that experience of last year, what might the IRS do to prevent similar problems in the future? Could the decline in customer service and the foregone enforcement revenue problem have been avoided? Did the IRS simply underestimate the volume of phone calls and what, if any, changes have been made to IRS internal processes as a result of lessons learned by the experience of last year?

Mr. SHULMAN. I tell our employees all the time, we were hit with stimulus last year, Recovery Act this year. We are working with the Department of Education around income verification for student loans, all sorts of things. I tell people that we execute quite well, which is the good news. The bad news, which is also in my view good news, is we are going to be asked to do a lot more. And so as you said, we implemented stimulus last year on top of regular filing and it wasn't just regular filing, it was regular filing with really late, like late December, changes to the AMT and other tax laws that had us scrambling and behind the 8-ball already.

Can I give you my perspective on filing season and tell you some of the things we are doing differently, to give you a sense of phone calls? In 2007, from January 1 to May 1st, we had 48 million phone calls come into our toll free line. Last year, during the stimulus checks, we had 64 million phone calls come through. So from 48 million to 64 million. This year it increased again, to 74 million. Part of it is Recovery Act, part of it is people truing up stimulus.

As far as estimating, I have looked at this. I wasn't there when legislation and plans were put in place, but I have asked the question. The only experience we had were the 2001 stimulus checks and 2002, and we didn't get that volume of phone calls. So I am not sure what we would have known. Once all the high number of calls started coming in, we did a few things that are ongoing. One is we have changed our scripts on our phone lines to try to direct more people to get automated service and to go to the Web. We have worked on just the science of call routing.

Two is we are investing in the Web. Let me give you an example from this year. This year one of the big questions is, "what was my adjusted gross income last year" because you need it for all sorts of Federal aid, but you also need it if you are going to true up your stimulus from last year. Because we are so serious about information security on our Web site, we have an authentication process which includes you having your adjusted gross income. We couldn't provide that on the Web this year. Next year we are working towards having "what is my AGI?" on the Web, so you can go in and get that information on the Web to push more people to the Web. The other thing we now have implemented is estimated wait times for almost all of the calls. And so some of that lower level of service is hang-ups. So you call in and it says, "it will be 15 minutes," and you hang up the phone and call back at a time when there will be less of a wait. We don't consider that all bad, because at the end of the day we have a limited number of resources and we need to make choices around those resources. But we are very focused on that.

BACKLOG OF PAPER PROCESSING

The last thing I would say is one of the biggest backlogs we had last year was from paper piling up. So amended returns, questions from taxpayers, responses to questions we sent out, et cetera. We peaked at over 2 million pieces of paper sitting there. We usually peak at about a million and we work it down to half a million by the end of the year. We, in that area, have now created lots of flexibility and cross-training of our workforce, so when paper comes in we can triage people on the phones, on the paper. Different units that used to be specialized can do more things. So we are very focused on this.

I stay focused. You were talking about level of service, which is one thing, phone level of service. I want to be very clear. If you have a 60 percent level of service, that does not mean 40 percent of people walk away unhappy. Some people hang up and some go to the Web. That level of service is just the people who actually get through and get their questions answered by a live assister.

I also focus on our American Customer Satisfaction Index scores, which have been steadily going up since 2000. So there are all of our specific measures, but then the big measure for me is when taxpayers are surveyed about their experience with the IRS, how they are feeling about it in a service context. Those numbers remained flat last year. We are going to have to keep working at it and we are very focused on it.

I don't want you to misinterpret and think we are happy with where we were. Any taxpayer who makes a call that doesn't get a good, quick response from us, I want to get better. But with all the resources, we are going to triage resources and make tradeoffs.

TRANSACTIONAL RECORDS ACCESS CLEARINGHOUSE

Mr. SERRANO. There has been some information and some of this obviously happened before you came on the job, but we want you to comment on these anyway. The Transactional Records Access Clearinghouse at Syracuse University had some data, and for fiscal year 2008 the audit rate for the largest corporations, those with assets greater than $250 million, was 27.4 percent, down from 44.1 percent in fiscal year 2005.

In addition, according to IRS data reported by the Transactional Records Access Clearinghouse at Syracuse University, the audit rate for millionaires dropped by at least 19 percentage points between fiscal year 2007 and fiscal year 2008. By contrast other categories of individual taxpayers and corporations experienced the same or even higher levels of audit coverage in fiscal year 2008 compared with fiscal year 2007.

Why do you think we are seeing these trends? Why have the audit coverage rates for millionaires in the largest corporations gone down while other audit coverage rates have remained steady or increased? And will the fiscal year 2010 budget request help to change that disparity?

Mr. SHULMAN. I am well aware of the statistics. We dispute, and I have gone deep into these numbers, the way that TRAC came up with some of those numbers. So, we think some of that is just wrong, and then some of it is looking at somewhat unfair comparisons.

We have doubled our coverage rate of large corporations in the last 5 years. We have seen a steady trend increase of audits of millionaires, or people with income over a million dollars, in the last several years, and you are going to see those trends continue.

As Commissioner of Internal Revenue with 100,000 employees and a $12 billion budget, I kind of think of myself the way I would hope America's CEOs think about themselves: they shouldn't be managing quarterly results in snapshots. They should be managing long-term trends and where the agency is headed.

The millionaires, that number did not decrease by 19 percent. There was actually a statistical error that we put out the fall before, and so we put the numbers out wrong before and everybody knew about this. We were very clear when those numbers came out. They came out wrong before I was there, but I stand behind them. There was not a 19 percent decline. There was a slight decline because the denominator grew. So the number of audits was relatively steady but the denominator grew.

Similarly with large corporations, the number of audits was steady, but the denominator grew. So that you know the general statistics, average taxpayers have about a 1 percent chance of being audited. If you have over a million dollars of income, you have a 5.51 percent chance of being audited. So we have much higher coverage rates of million dollar folks.

The other thing that contributed, frankly, to some of these numbers is continuing to be under continuing resolutions where we freeze hiring. People have to cut back, we are not adding and filling bodies. In both those years we were under continuing resolutions. As head of an agency and seeing what that is like this year, I did some things with high income audits and international, to continue our hiring and take a bet, and saying I was going to cut other places if the appropriation wasn't passed, which it was, but that creates some issues.

So, I guess what I would say is the long-term trends are going to be continued focus on large corporations, high net individuals, flow-through corporations and international. Those are my priorities. Those are on enforcement and that is where the 2010 budget is giving us more resources. These numbers are going to fluctuate in certain years. And as I said before, we are hiring a lot of people this year and next year. We are going to take some of our best people off to train them. You may see fluctuation in numbers as they are training, but our long-term investment is to have a trend where we make sure wealthy individuals and large corporations, who have really benefited from being in the U.S. and from all our rules and economy, pay their taxes. We are also going to have coverage in all spectrums, so that everybody knows that their neighbor is paying taxes if they are paying taxes.

USE OF STATISTICS

Mr. SERRANO. In your answer just now in disputing these numbers you used the phrase or word "unfair." What was unfair?

Mr. SHULMAN. Well, we put out enforcement statistics and then we put out our statistics of income. Some of those use different measures. I mean, we hold the data for all the income in the U.S. and for the taxpayers. It is a very important data set for this country. I am a big fan of people watching our numbers and reporting on our numbers and having a public debate. I think that keeps us on our toes and leads to a vibrant democracy.

I think on large corporations we had a slight decline of actual audit closures, but most of those large corporations are under audit anyway, so we just didn't close out audits. The denominator grew. The way I would look at it is, with the resources we had, we did as many audits. They chose to look at percentages instead, which is what I mean when I say unfair. Everyone decides what their headline is going to say. They chose to have a different headline. And I think picking the period, I think you said 2005 to 2008 was the number that was picked.

Mr. SERRANO. Right.

Mr. SHULMAN. That may be a correct number or it may not be, but we doubled the coverage in the last 5 years. And so one trend says we have gone down and one says it has gone up. When I used the word "unfair," that is what I was talking about.

SERVICES FOR LIMITED ENGLISH PROFICIENCY TAXPAYERS

Mr. SERRANO. Thank you. Before I turn it over to Ms. Emerson, I want to delve into one area here. Can you tell me what is the status of the services you render to limited English speaking folks. I know you made some serious progress, for instance, in putting together the "Where's My Refund?" feature on the IRS Web site in Spanish. What can you tell me about where you are heading? And do you see more and more need for these services?

Mr. SHULMAN. When we had a chance to talk before, I told you, directionally and conceptually, where we are headed in service is to move as many people as we can to self-serve on the Web. But we will also continue to have a robust suite of in-person phones, volunteer sites, grants for low income people and for underserved populations. I view the limited English proficiency population as often underserved by us. We can always do better. We have done a whole set of things, for example, around trying to have a Spanish-language Web site, having publications translated, making sure when we are working in an area of the country that has non-English speaking or people for whom English isn't their first language, we are staffed with people with appropriate language skills. Our media department has a special outreach to non-English media outlets around the country.

So we have had a focus. I am not going to sit here and tell you we are as far as we need to go. So we are going to keep pushing in that direction on getting as many people on the Web as we can. If there are specific targeted populations that need to be served, we are going to keep trying to serve them better.

Mr. SERRANO. Thank you. Ms. Emerson.

NARCOTICS TRAFFICKING

Mrs. EMERSON. Thank you. I am switching the subject here. Back in I guess fiscal year 2009 the IRS Oversight Board recommended that Congress provide $24 million above the budget request to enhance financial investigations of narcotics trafficking organizations.

Mr. SHULMAN. Yes.

Mrs. EMERSON. Estimates are that over 7,000 people have been murdered in Mexico as a result of the ongoing drug war between cartels and Mexican authorities since January 2008, and we all know that there has been spillover violence in Georgia, Alabama, and Arizona, not to mention all of the drugs that enter into the United States, whether it is cocaine, methamphetamine, heroin. We have too much of it in my home State of Missouri.

Is the IRS Oversight Board correct, should we dedicate additional resources to financial investigations of drug traffickers? That is my first question. And then how do you all interface or work with the Departments of Homeland Security and Justice to address violence? I don't know that you would actually do that specifically. And does the IRS typically generate a significant amount of enforcement revenue from taking down drug trafficking organizations.

Mr. SHULMAN. It is a great question. We have a very strong Criminal Investigation Division, who, obviously, specialize in finance. Taxes is their roots. But I think they are well known as, probably, the best forensic accounting criminal investigators there are, worldwide.

We have very close working relationships with the FBI, with the Justice Department, with lots of local law enforcement and others.

And we are brought in, often, when there is a tax matter. But our people also assist on nontax matters relating to all sorts of criminal activity.

And so I think this is always just a balance. It is always recognizing we are all the Federal Government trying to aim in the same direction, but we all have our jobs to do. So there has been an ongoing dialogue about how much of IRS agents' time is spent on nontax matters, because criminal tax enforcement is vital to the tax system. You know, the ultimate hammer is you go to jail if you evade paying your taxes in a criminal method; so people need to be reminded of that, and we balance that time.

So I have actually kept the number relatively steady. I have good relationships with the head of other bureaus that are involved in crime, the head of the FBI and others. And we are going to pitch in where we can, but recognize we have limited resources.

Regarding the Oversight Board's specific requests, the Oversight Board is incredibly thoughtful. I can't speak for the Oversight Board, but I interact with them quite a bit. They view their job as recommending what we need to do our job without the constraints of an overall budget. And obviously the Administration has education, health care, energy, the economy, lots of things to wrestle with.

So I am supportive of what we have here. We are going to make do. It is very similar to some of the questions about service, and our service levels. It is always my job to advocate for the agency, get all the resources we need. But in doing so, we have got to make choices. And I think the choices we have made in this budget are very prudent. I think they are ones that are going to lead us to good enforcement, good service, good investments in the future.

Mrs. EMERSON. I appreciate that.

TROUBLED ASSET RELIEF PROGRAM

Switching gears yet again, the Special Inspector General for the TARP has stated in written testimony, and I will quote: "We stand on the precipice of the largest infusion of government funds over the shortest period of time in our Nation's history. History teaches us that an outlay of so much money in such a short period of time will inevitably attract those seeking to profit criminally. If, by percentage terms, some of the estimates of fraud in recent government programs apply to the TARP programs, we are looking at the potential exposure of hundreds of billions of dollars in taxpayer money lost to fraud," end quote.

Are you all detailing staff to the Special Inspector General to provide experienced financial auditors and examiners to support this critical mission, particularly since I know he is short-staffed? And secondly, what are the tax implications for the banks receiving TARP funds? I mean, how do they report the income received from the TARP and the dividends paid to the government? And that is more of a process question. I am very curious how that happens or how they report that.

Mr. SHULMAN. Let me start at the broadest response to this and then get to your two specific questions.

In the broadest sense, I think the President has been very clear about this in his speech before Congress, which is there is the decision by the Administration that this extraordinary economic times needed, a very powerful response. Obviously Congress, through a combination of approving the TARP, approving the Recovery Act, agreed with that.

At the same time, there are unprecedented outlays. There is going to be leakage, there are going to be mistakes, and there is going to be fraud. So what this Administration has tried to do is respond appropriately and forcefully and aggressively with cash outlays to get the economy moving again, but at the same time make sure that we try to account for every dollar spent and try to minimize leakage.

It is not going to be perfect on either end, right? With TARP, yes, we detailed people to TARP to help with their efforts because we know it is so important to the economy. Regarding the tax treatment of TARP funds, we have put out a lot of guidance. Some of it is loans, some of it is equity, some of it is convertible equity. It is hard to speak in broad generalizations because the money has been used in different ways. But because the government has been doing innovations, we have had to be very clear about our interpretations, and we have worked closely with Treasury to make sure that the proper tax treatment under the law is what has happened with TARP recipients. I would be happy to go through all the details with your office.

Mrs. EMERSON. That would be terrific. Thank you very much.

Thanks, Mr. Chairman.

Mr. SERRANO. Thank you.

I only have a few more questions.

Mrs. EMERSON. I have a few more, or I can submit them for the record, whatever you prefer.

Mr. SERRANO. We will keep him here until 3 o'clock. No, I am only kidding.

FLEXIBILITIES IN IRS ACTIONS

Your main role—well, one of your main roles is definitely to collect taxes, and we all support that, the fact of that mission. But these are difficult economic times, and we read daily about people losing their homes, people not being able to buy groceries, people not being able to pay tuition. And I am sure there are people who at the end of the year owe money, who didn't intend to owe money, who didn't do anything improper to owe money, but they do. Does the IRS in any way take that into consideration, and how do you deal during this very difficult time with the fact that there are some people who owe money that can't pay it right now?

Mr. SHULMAN. That is a great question. I am quite proud of the Agency for the way we have responded to this this time.

Last August and September I sat down with our senior staff and said, I think all the experts agree, the people we work with, my colleagues at the senior levels of government, that we are headed into an uncharted territory with the economic time, and it ended up being true, unfortunately. And we said, we are going to find taxpayers for the first time who are in incredibly difficult, dire straits, making choices between paying for their mother's medicine or paying tuition for their kid or paying their taxes, and what can we do to respond within our administrative authorities? We need to keep in mind the tension. More than ever we need to fund the government because the government has, through a whole set of circumstances, very large deficits, and so we need to collect the money. So if you can pay, you have to pay; but if you can't pay, we need to be fair and compassionate as an agency.

We put in place a whole number of programs, shifted some resources. One is for small businesses and businesses generally, we recognize that expedited refunds would be a lifeline for cash with frozen-up credit markets. We actually shifted resources to deal with people who are coming in and asking for expedited refunds. There is a procedure that allows you to do that. So we made sure we were staffed up there.

We work closely with individuals, especially our collection personnel. What I did was raise the limits. The number is not public, and we are not going to make it public, but under a certain threshold, if you are out doing collection, our frontline employees have lots of discretion about what they do with people. So we can suspend collection for 6 months to let people get through a rough time, and we gave people more authority to do that.

With housing, a lot of times in offering compromise, the reason you don't get an offer in compromise is because you have home equity. But the way we know you have home equity is we see your appraisal, we see your mortgage, we know you have home equity. We recognized that the housing market was in dire straits, and that actually a lot of these appraisals weren't the true value of the home because the value was plummeting so rapidly. We set up a specialized unit of real estate specialists who work in coordination with realtors' associations around the country. So normally we would reject an offer in compromise because the documentation didn't show decreased home value. Any time an offer in compromise is rejected during this period—and it is still ongoing—because of home equity, it gets kicked to our specialized unit to have a second look.

We also set up expedited levy release; so if we were levying your bank account, and you were released, you would get the money a lot quicker. We set up a section on our Web site which is called "What If"—What if I lose my job? What if I lose my home? What if I lost one of my jobs? What if my income declines?—those kinds of things. All of it is geared towards doing right by the American people and being compassionate. We deal with every single taxpayer, and they need to have faith in their government, but it also helps for just the pure collection of taxes.

We are in this for the long haul, and the last thing we want to do is be unfair with someone, have them drop out of the system. What we want to do is keep them in the system for the long run. We want to make sure we have as much flexibility as possible to help them through this difficult dip in the economy, where there are people who have been paying their taxes their whole life and for the first time can't pay their taxes.

So as an agency we responded to this. We pushed a lot of judgment into the hands of our people, and we gave them the authority to work with taxpayers during a difficult economic time. I think the response has been good. I think we have hit the balance right. We are always going to be fine-tuning this balance, but it is an example of how we are trying to fine-tune this agency so when surprises come at us, we can respond rapidly.

FLEXIBILITIES IN IRS ACTIONS

Mr. SERRANO. And I am glad you are doing that, because when you watch the news, when you read, you see, you hear the horror stories of people not being able to pay their mortgage or all the other issues that I mentioned before, but you never hear about people paying their taxes, because that is always assumed that you have to or else, and only a bad person will not pay their taxes. But the fact of life is if a person hasn't been able to pay their mortgage or their rent for the last 4 or 5 months, and then owes $2,000 to the IRS through no fault of their own, just the math, I mean it happens to all of us, that is a tough thing to deal with, whereas paying—as sad as not paying the mortgages and the rent, there is nothing illegal about that, whereas not paying your taxes, owing taxes, there are laws against that; so that just adds to the stress level.

Mrs. EMERSON. Can I add something really quickly?

Mr. SERRANO. Sure.

Mrs. EMERSON. It is interesting particularly how you have changed or been a little more flexible on the equity issue in the house, because even if there is equity in the house, it doesn't mean necessarily that the homeowner would be able to qualify during these economic times to even grab out any of that equity to pay off. So I appreciate the fact that flexibility, which probably has not traditionally been the hallmark of the IRS, seems to be an important part of how you are working with people who are under terrible stress right now.

Mr. SERRANO. I can see the new IRS Web site: "We Have a Heart."

Mrs. EMERSON. "We Are Flexible."

Mr. SERRANO. "We Are Flexible."

THE IRS WORKFORCE

I have one more question for you, Commissioner. The operating plan for fiscal year 2009 notes that "as early as fiscal year 2010, 20 percent of the total IRS workforce, including 30 percent of all IRS managers and 47 percent of IRS executives, are eligible to retire. The operating plan further notes that 2009 funding will be used to enhance recruiting and training programs and help attract, develop, and retain an outstanding workforce." That is the quote.

Please describe for us some of the ways in which the IRS is preparing to cope with this coming wave of retirements.

Mr. SHULMAN. As I mentioned earlier, my view as the leader of IRS, is there is nothing more important that I do than focus on our workforce. I pulled one of our senior operating executives out of the field, had her report to me directly for the last year, to focus with our HR department on workforce issues. I am a big believer that workforce isn't just an HR problem, it is actually a leadership problem. People look to their managers and they look up their chain of command to the people running the agency for leadership.

RECRUITMENT AND RETENTION

We, like every Federal agency, have this impending retirement boom. We are using this recession, in which fewer people are retiring because their retirement savings have shrunk. A Federal job is actually a great, well-paying, stable job, and so some of our attrition numbers have fallen off. But we are not going to rest on our laurels, because as the economy rebounds, we could have a cliff of retirement. So, people who are eligible to retire this year don't retire, the ones who are eligible to retire next year don't retire, and then the year after, all three of those waves actually decide to retire. And so we are laying the groundwork to really invest in the workforce of the future.

One thing we have done is centralized recruiting. As we are doing recruiting now for revenue agents, revenue officers, and lawyers, we are running it centrally out of a group that is reporting to my two Deputy Commissioners, who are involved in this every week. I get an update every week. In the past, it was very decentralized. So it allows us to leverage hiring, see candidates across the whole organization. So we have made this an enterprise priority.

Two, we are focusing on fewer institutions for recruiting. Instead of having a scattershot approach to 1,000 colleges and universities around the country, without deep relationships, we are going to target 100 and have much deeper relationships. We want to get to know the heads of the accounting departments, the deans of the law schools, the different professors, so that we are doing recruiting as we go. And so we are using this current hiring wave as an experiment around more focused centralized recruiting.

We are also making senior executives responsible for recruiting in geographic areas and developing relationships with the schools. If the head of an accounting department goes to meet somebody who runs a business unit, it is a much more engaging conversation than meeting an HR specialist who just does recruiting. And not to denigrate—I mean, we have a great HR group and they have an important role to play—but it is a partnership role. So we have a lot of focus on recruiting.

RECRUITMENT AND RETENTION

We are also focusing on making the IRS a great place to work. And some of the examples of the things we are doing is trying to get rid of what I call "administrivia," where managers spend more time filling out forms and not as much time mentoring and developing people. So we have a very focused effort on trying to knock down some of the paperwork burden of our frontline managers so that's an attractive job, and so people can spend time managing, leading, motivating, coaching, and not spending as much time on non-value-added administrative work. And my belief is these things kind of build on each other.

So we are also working on just training our leaders and managers to be great leaders and managers. We are driving a culture and a set of values through the organization that I am trying to teach by example, values like respect, continuous improvement, valuing diversity, personal accountability. People aren't seeing me promote people who don't live up to that set of cultural values.

I am challenging managers and the senior people. You have a subject matter expert who maybe doesn't exhibit the long-term behavior you want, but those people sometimes get promoted in large organizations. We are trying to be very focused on the future, because I believe if everyone shows up to work feeling respected, feeling they know what their job is, feeling that they are rewarded if they hit their goals, feeling that they are coached, mentored, it becomes a self-fulfilling prophecy. If they don't, the dead weight is moved out. People stay longer. People recruit their neighbors to work there, and the agency grows and flourishes. So I am very passionate and very focused on people issues, as is our whole senior team.

TAXES AND PROFESSIONAL BASEBALL

Mr. SERRANO. In closing my part, let me just tell you that there is an ongoing joke in the committees I serve on is how long before I bring up Puerto Rico or Cuba. But it doesn't fit in this hearing. So I will bring up something related that I am always curious about.

You have folks here who come to play baseball, professional ballplayers, and they come from other countries. Do the Major League teams withhold their taxes just the way all other Americans get, or are they on their own with their business manager to pay their taxes? And, you know, you have States that have these arrangements where if you live in one State and work in another, you pay in one, and the other one recognizes the fact that you are living here and working there. There is no arrangement between countries; right? These millionaires pay in both the place where they have a legal residence and where they play ball; am I right?

Mr. SHULMAN. Is this a baseball question or a tax question?

Mr. SERRANO. A tax question.

Mr. SHULMAN. Let me get back to you. I mean, I think you have different arrangements with——

Mr. SERRANO. So the question was not as silly as I thought.

Mr. SHULMAN. No. I don't want to give you the wrong answer, especially around a baseball question.

Mr. SERRANO. Around a millionaire question. See, it always causes a problem. Okay. Thank you.

SECURITY INFORMATION TECHNOLOGY WEAKNESSES

Mrs. EMERSON. I have two IT questions, and then I will put the rest in the record, Mr. Chairman, if you like.

Over the past several years, GAO and Treasury Inspector General for Tax Administration have been critical of the IRS's IT security weaknesses, and so I am really very pleased that the budget proposes an increase to address that issue.

Three questions with regard to this: What processes are in place to inform taxpayers if their personal information has been compromised? Number two, what will the additional $90 million included in the budget request provide? And number three, if this request is funded, and I am assuming it is going to be, can we expect the IT security criticisms from the GAO and others to be either minimized or eliminated totally?

Mr. SHULMAN. I have been very clear that we have a sacred trust. The American people send us their financial information, and we need to be very focused on information security. I came into the job about a year ago, sat down with both GAO and our Inspector General, looked at those reports, and directed our team to take the findings very seriously. Start telling me what budget they need to knock down some of these security weaknesses and, pay attention to it and not always prioritize new functionality against security weaknesses.

I will say you are never going to get to zero potential security weaknesses, and I will also say these reports have not talked about security breaches. They have talked about places where they could potentially be. So the American citizen should feel very confident that their information is protected at the IRS, but as the world changes, as people trying to do bad things with computer systems change, we need to stay ahead of that curve.

For the processes for informing people, we have a privacy office that is very focused on identifiable information: Social Security number, name, dates of birth, the kinds of things you can use for identity theft. We have not had incidents of leakage out of the IRS in the area of identity theft, but we are very focused on that.

We have a joint operations committee from which, literally, every morning I receive an e-mail that shows all sorts of physical security, information security issues, et cetera. It goes out to all our executives. I receive it and review it daily. Any time that there is a potential loss of data—of taxpayer data—that could harm a taxpayer, it goes to our head of Information Security and Disclosure. There is a committee that meets, looks at what the breach is, looks at the Federal standards about notification. If there is a need for notification, we do notification, and we err on the side of caution. So we notify lots of taxpayers that we found a security weakness, or a letter went out with your address to the wrong person. As we are dealing with 130 million taxpayers, mistakes happen, and we send letters out to them so they can double-check and make sure things are fine.

The other thing is we set up an identity theft specialized unit last year. It used to be decentralized. Identity theft usually comes to the IRS not because you lost your identity through the IRS, but because someone steals your identity, and then they file a tax return with a fraudulent refund, or you are having a hard time getting your return because something happens. So we now have special indicators, a whole program to work through that issue. Again, when an American citizen has a devastating financial situation with identity theft, we want to be part of the solution.

INFORMATION SECURITY

Your second question about what we will do, I think it is very important and lobbied hard to get the $90 million that we put in for security and material weaknesses. It is going to knock down not the whole list of everything that the IG and the GAO have ever shown, but a lot of the ones that we have decided are important.

One of the most important things that will happen is new systems. And on some of the old systems, we are going to put in audit logs, because there are always threats from the outside, but we have 100,000 employees, so we need to make sure we can track what people inside are doing. So a lot of that funding is to audit logs and addressing the weaknesses that were in those reports.

As to your last question, what I will tell you is some of the long-term investments, such as in modernizing our data accounts, will help us to get a fully modernized data system. That is, a relational database for taxpayers, to knock out some of the material weaknesses that have been ongoing with GAO, like tracking accounts receivable at the entity level in our general ledger. So, some of that will take more time. This $90 million won't take care of it all. A lot of things will be knocked down.

I certainly hope that the GAO and the TIGTA will see progress, but I can't speak for them. But what I will tell you is I believe in a balanced IT portfolio that invests in the future, that shores up current systems, and that invests in infrastructure. I think before I got here, there was a lot of emphasis on modernizing. Modernization is in the eyes of the beholder. But I have been very focused, and this budget reflects my handprint around a balanced portfolio of technology that sustains the good work already done, shores it up, focuses on security, builds the new database.

BUSINESS SYSTEMS MODERNIZATION

Mrs. EMERSON. The thing that makes me so nervous about doing new IT or business modernization systems is just the history that we have seen from other departments within the government and the billions and billions and billions of dollars that have just been wasted. Are you comfortable with the processes you have in place to ensure that whichever contractor you hire can execute all of the changes that you need made, and that you can stay on track with those changes?

Mr. SHULMAN. Let me say a couple things about my views on technology. One is in my life before this, I have built big infrastructure for the securities industry of the country, high-speed trading networks. Building big technology is difficult. Technology is changing. Expectations of the users are changing, American taxpayers' expectations about the technology can change. It is also a nonlinear process. You don't say, "right here, for the next 5 years, this is the plan," because the world changes, and you learn as you go, and expectations change as you go.

So it is usually best to breed technology when you do development. Usually it throws away about 30 percent of the code. So if you're at a big corporation, the board of directors looks at it and says, "we are going to spend a million dollars," but about $700,000 of that will actually get implemented. That is not $300,000 of waste. That is the cost of operations, and that is what it takes to iterate through the process.

Sometimes in government people have bungled it and wasted money, and sometimes people have characterized some of the throwaway, which is natural in a big IT program, as waste, when in reality that is just the way that IT works going forward.

I am quite confident in the IT leadership. I brought in a new Chief Technology Officer who had been Chief Technology Officer of Boeing, which had old systems that had to be revamped. He had been Chief Technology Officer of EDS. He had been Chief Technology Officer of Visa International. That person now runs our IT department, oversees contractors. So he has been a big contractor at EDS. He knows you need to hold people accountable, partner with them appropriately, but not absolve your responsibility for oversight.

BUSINESS SYSTEMS MODERNIZATION

We are very focused on having the right combination of drive to get it done with tight processes and controls along the way. What I have told you privately, and I will say publicly, is I believe you put projects in place that you can get done on your watch. Success is a combination of the systems and the processes and the people, but it is also the leaders staying focused on the project. And so the modernization portfolio we are putting forward finishes our e-file project, which allows the whole 1040 series to be electronically filed not on our current standard, but on XML technology that can be used by everyone who e-files. So it is a lot more user friendly and stable. And the main thing we will get done is our account database—the goal is on my watch—which then allows us to really move forward into Web services and internal use of data for enforcement purposes.

And so I am confident we are going to stay focused on it. My track record is that when I stay focused on it, things get done. I never promise that everything is going to be done perfectly, but we know that we are asking for money, and we are asking for people to believe we can get it done. I think I have got as good a team as I have seen in private-sector or government, so we have a good chance of getting it done, and we will keep running tight processes to maximize the chances of good, strong delivery.

Mrs. EMERSON. Hopefully you can serve as an example to the rest of government then. Thank you very much.

Mr. SERRANO. Thank you. I will submit the rest of my questions for the record.

You have questions.

Mrs. EMERSON. I have questions I would like to submit as well.

Mr. SERRANO. It shall be.

CLOSING STATEMENT

We thank you for your testimony. We stand ready to assist you. We fully understand the role that you play, how important it is. I was very appreciative of your comments that the agency will be sensitive to the fact that during difficult economic times, people who intend to be good citizens that pay their taxes run into issues, situations just like they did with their mortgage or their rent or the children's tuition. They didn't intend to, it just happened that way. And it is very important for us to hear that.

It is important for us also to hear that you will continue to reach out to those folks who have limited proficiency in English to help them walk through the system and the fact that you are reaching out to the taxpayer to try to help them. We stand ready to assist you in every way. So we congratulate you on that work, and, as I say, we understand how difficult this job is, but you seem to continue to want to do it and do it right.

Let the record show, however, that the Commissioner did come here unable to answer just one question: How baseball players pay and where they pay their taxes. And that is one that I think we will get quite a bit of study and analysis.

But we thank you for your service, and we thank you for your testimony here today.

Mr. SHULMAN. Thank you.

Mr. SERRANO. The meeting is adjourned.

QUESTIONS FOR THE RECORD SUBMITTED BY CHAIRMAN JOSE E. SERRANO

TAXPAYER SERVICES

1. With regard to the budget request for Taxpayer Services, the overall Taxpayer Services request is one percent below 2009, while the Filing and Account Services budget activity, which includes both submission processing costs and the cost of running the IRS 1–800 help line, among other things, is 2.2 percent below last year. If the IRS falls short of its electronic filing goals next year—and submission processing costs rise as a result—is there a risk that the IRS will be left with insufficient resources to staff the 1–800 help line service, and that taxpayer service will suffer as a result?

2. The fiscal year 2010 IRS budget submission shows that the IRS is planning a 71.2 percent Level of Service on the IRS 1–800 help lines for fiscal year 2010. This is lower than the 82 percent Level of Service achieved in fiscal year 2007. What is the IRS currently doing to improve the Level of Service on the phone lines, and why isn't the IRS aiming for a higher Level of Service on its phone lines for fiscal year 2010? Would a higher appropriation for Taxpayer Services, above the budget request, ensure a higher Level of Service on the 1–800 help lines?

AUDITS OF LARGE FINANCIAL SERVICES COMPANIES

3. IRS data, as reported by the Transactional Records Access Clearinghouse at Syracuse University, show that only 15% of large financial services companies were audited in 2008, compared with 64% of all other large corporations. Why are large financial services companies less likely than other large companies to be audited? Is the IRS budget request for Enforcement designed to help boost the number of audits of large financial services companies?

BUSINESS SYSTEMS MODERNIZATION

4. With regard to Business Systems Modernization, I understand the IRS is embarking on a new direction with regard to the Customer Account Data Engine, the project aimed at modernizing the taxpayer database. Please describe for us exactly what BSM schedule changes the IRS is envisioning, and why. What was wrong with BSM's previous schedule? Are you confident that full modernization is still on track, and that delays and cost overruns will be avoided?

HEALTH COVERAGE TAX CREDIT

5. The American Recovery and Reinvestment Act included changes to the Health Coverage Tax Credit program, designed to expand the numbers of taxpayers who are eligible to participate in the program. To help the IRS handle the increased volume in fiscal years 2009 and 2010, $80 million in supplemental appropriations was provided to the Health Insurance Tax Credit Administration. Does the IRS have a reliable estimate at this point as to how many additional taxpayers are participating or will participate in this program? Is the $80 million in additional supplemental appropriations sufficient to allow the IRS to effectively administer this program this year and next year?

6. The budget request assumes $13.7 million in savings as part of a "Government-wide Reduction for Productivity Improvements." Please describe the current types of expenditures and inefficiencies in which the IRS expects to achieve cost savings.

Why are a disproportionate amount of these savings—$10.6 million—expected to come from the Operations Support account?

AUDIT RATES

7. For each of fiscal years 2007 and 2008, how many correspondence audits were conducted of taxpayers with adjusted gross income between $100,000 and $200,000?
8. For each of fiscal years 2007 and 2008, how many face-to-face audits were conducted of taxpayers with adjusted gross income between $100,000 and $200,000?
9. For each of fiscal years 2007 and 2008, how many correspondence audits were conducted of taxpayers with adjusted gross income greater than $200,000?
10. For each of fiscal years 2007 and 2008, how many face-to-face audits were conducted of taxpayers with adjusted gross income greater than $200,000?

Questions for the Record from Ranking Member Emerson

Criminal Investigators

Currently there are approximately 2,600 IRS special agents who investigate tax and money laundering crimes involving tax schemes, corporate fraud, non-filers, employment tax fraud, and crimes associated with drug trafficking and terrorist financing. This level is down more than 200 positions from fiscal year 2002. Recently, the Treasury Inspector General for Tax Administration found that in 2008, the number of criminal investigations initiated declined by 11 percent, and the number of criminal investigations completed decreased.

- Why are the number of investigations initiated declining?
- Do you need additional criminal investigators?

Taxpayer Services

The IRS operates several programs designed to help taxpayers prepare their filings including a telephone service, information provided on the internet, walk-in centers at IRS facilities, a volunteer income tax assistance program, a counseling program for the elderly, and the Taxpayer Advocate Service. Enhanced taxpayer services will improve compliance, reduce the tax gap and improve taxpayers' opinion of the IRS.

- How would the average person learn of these services?
- Do you use different strategies to promote awareness in rural areas versus urban areas?

Document Matching

The budget request proposes a $26 million increase to expand document matching to increase the IRS' ability to use automation to match information with the amounts reported on tax returns. This increase is on top of a $35 million increase provided in fiscal year 2009.

- How much enforcement revenue do you raise through using automation to match documents?
- How will the $26 million requested increase enhance this program?

Small Business Compliance

The tax gap is estimated to be $290 billion. I understand that 75 percent of the tax gap is estimated to be associated with small businesses and the self employed. The budget request includes an increase of $94.2 million to improve reporting compliance of small businesses and the self employed. This is on top of a $168 million increase provided in fiscal year 2009 to address the same issue.

- How much non-compliance do you believe is intentional and how much is due to a lack of understanding the tax code?
- What are you doing.to help small businesses understand the tax code?
- When a mistake is found in their return what options do they have to repay their debt?

Cap and Trade

If cap and trade or some similar tax legislation related to climate control is enacted, what role will the IRS play in implementing this legislation and collecting climate taxes?

Have you estimated how much additional funding the IRS will require in order to implement a cap and trade system?

Questions for the Record
Submitted by Chairman José E. Serrano

1. With regard to the budget request for Taxpayer Services, the overall Taxpayer Services request is one percent below 2009, while the Filing and Account Services budget activity, which includes both submission processing costs and the cost of running the IRS 1-800 help line, among other things, is 2.2 percent below last year. If the IRS falls short of its electronic filing goals next year--and submission processing costs rise as a result--is there a risk that the IRS will be left with insufficient resources to staff the 1-800 help line service, and that taxpayer service will suffer as a result?

   Answer: In FY 2009, the IRS received $67.9 million in non-recurring funding to implement the Economic Stimulus (ES) payments. Net of that funding, the FY 2010 budget request for Taxpayer Services actually reflects a 2.0 percent increase over the FY 2009 enacted level. In addition, the IRS received $123 million to implement the American Reinvestment and Recovery Act (ARRA), $52.6 million of which is projected to fund Taxpayer Services ARRA related workload in FY 2010. This ARRA funding and the taxpayer service funding in the FY 2010 request provide adequate funding for submission processing and the 1-800 help line.

2. The fiscal year 2010 IRS budget submission shows that the IRS is planning a 71.2 percent Level of Service on the IRS 1-800 help lines for fiscal year 2010. This is lower than the 82 percent Level of Service achieved in fiscal year 2007. What is the IRS currently doing to improve the Level of Service on the phone lines, and why isn't the IRS aiming for a higher Level of Service on its phone lines for fiscal year 2010? Would a higher appropriation for Taxpayer Services, above the budget request, ensure a higher Level of Service on the 1-800 help lines?

   Answer: The IRS is dedicated to providing the best possible service regardless of the channel the customer chooses. In 2010, we plan to continue to support the Toll-free program as in prior years; however, increased customer demand, the introduction and expansion of new programs such as the Identity Protection Specialized Unit, and increased complexity of the calls handled by assistors is expected to result in lower service levels than was delivered prior to 2008.

   We are taking numerous steps to prepare for the coming year and maximize service to customers. During the 2009 filing season, there were 4.8 million calls from taxpayers asking for their prior year Adjusted Gross Income (AGI) or Personal Identification Number (PIN) which is required by online filers to submit their returns electronically. For 2010, we are developing both a web and automated telephone application to provide this information to taxpayers without requiring interaction with an assistor. This will free up assistors to handle more complex taxpayer questions. We will be implementing improvements in our Toll-free menus, which will get customers to the right resource faster. We will be expanding the use of estimated wait time announcements to more applications and customers. Lastly, we are planning to increase the number of staff on-rolls at times of peak customer demand during the filing season, through seasonal hiring.

The IRS believes, considering the competing demands and priorities for resources in the FY 2010 budget, the current request is sufficient to meet taxpayers' needs.

3. IRS data, as reported by the Transactional Records Access Clearinghouse at Syracuse University, show that only 15% of large financial services companies were audited in 2008, compared with 64% of all other large corporations. Why are large financial services companies less likely than other large companies to be audited? Is the IRS budget request for Enforcement designed to help boost the number of audits of large financial services companies?

Answer: The audit percentages referred to in the question do not accurately reflect the IRS' recent audit and compliance activities in the financial services industry. The IRS maintains a vigorous, balanced enforcement program in the financial services sector. This analysis overlooks the true number of audits in the financial sector because the majority of these reviews are done by examination personnel not directly assigned to the financial services sector. Taken in isolation, the TRAC findings are oversimplified and misleading.

The IRS divides its work on large corporations into five sectors: financial services; retail, food, pharmaceuticals, and healthcare; natural resources and construction; communications, technology, and media; and heavy manufacturing and transportation. In 2008, several key audit measures for the financial services industry group generally exceeded those for these other major industry groups. For example, in 2008, the time recorded as spent by IRS employees auditing financial services industry taxpayers exceeded that of the time recorded as spent on audits of any other major industry group of large businesses. Further, for 2008, the number of financial services company audits closed by the Large and Midsize Business Division of the IRS (LMSB) was more than double that of the number of cases closed in any of the other four industry groups. And the number of financial service companies examined during 2008 in our Coordinated Industry Cases (CIC) program, which involves audits of many of the largest businesses, was over 40% of all taxpayers examined in the CIC program.

The IRS Enforcement budget request was based on the need to step up enforcement on key international and emerging issues. This focus will include large financial services companies.

4. With regard to Business Systems Modernization, I understand the IRS is embarking on a new direction with regard to the Customer Account Data Engine, the project aimed at modernizing the taxpayer database. Please describe for us exactly what BSM schedule changes the IRS is envisioning, and why. What was

wrong with BSM's previous schedule? Are you confident that full modernization is still on track, and that delays and cost overruns will be avoided?

__Answer:__ We have consistently delivered on our commitments over the last several years of Business Systems Modernization, and processed nearly 40 million taxpayers' returns using the new CADE database. This year, the IRS has adopted a much more focused strategy that will allow the IRS to complete the taxpayer database conversion on an accelerated timeframe. The IRS is doing this by gradually shifting course from simultaneously developing a new taxpayer database and its associated applications to a more streamlined focus on completing the taxpayer database conversion.

While a complete, modernized taxpayer account database will be a major accomplishment in its own right, it will also position the IRS well for future online and automated services, as well as new compliance and enforcement systems.

The BSM program over the years has taken many steps to ensure appropriate discipline in managing cost and schedule. The program management capabilities have improved in meeting cost and schedule targets for project deliveries. In order to continue to improve its capabilities, the IRS also has initiated efforts to institutionalize additional industry best practice process methodologies such as:

- **Information Technology Infrastructure Library** (ITIL is best practice guidance for IT Service Management owned by the British government);
- **Capability Maturity Model Integration** (CMMI a process improvement approach developed by the Software Engineering Institute of Carnegie Mellon University): and,
- **Lean Six Sigma** (a business management strategy that maximizes shareholder value by improving quality of process outputs).

Later this year, the BSM program team will provide a detailed expenditure plan to the Committee, outlining in great detail the milestones, deliverables and program plan.

5. The American Recovery and Reinvestment Act included changes to the Health Coverage Tax Credit program, designed to expand the numbers of taxpayers who are eligible to participate in the program. To help the IRS handle the increased volume in fiscal years 2009 and 2010, $80 million in supplemental appropriations was provided to the Health Insurance Tax Credit Administration. Does the IRS have a reliable estimate at this point as to how many additional taxpayers are participating or will participate in this program? Is the $80 million in additional supplemental appropriations sufficient to allow the IRS to effectively administer this program this year and next year?

__Answer:__ The first ARRA provision for HCTC became effective April 17, 2009, when the amount of the credit changed from 65% to 80% of monthly health premiums. The IRS estimates that as of May 1, 2009, HCTC enrolled 1,420 new participants and made $1,840,769 in additional HCTC payments due to ARRA.

The IRS used research conducted by both the Congressional Budget Office and the Department of Labor to develop a scenario for the potential increase in individuals claiming the HCTC. The scenario estimated the number of individuals receiving monthly payments to their health plans could increase from 15,000 to 57,000. Based on these models, the current supplemental appropriation for FY2009 and FY2010 will support HCTC operations at the higher levels.

6. The budget request assumes $13.7 million in savings as part of a "Government-wide Reduction for Productivity Improvements." Please describe the current types of expenditures and inefficiencies in which the IRS expects to achieve cost savings. Why are a disproportionate amount of these savings--$10.6 million—expected to come from the Operations Support account?

Answer: The reduction for productivity improvements represents a .5 percent reduction to the non-pay inflation assumption. This reduction affects the Operations Support account more than the other accounts because the Operations Support account funds more non-pay items, such as IT software/hardware and other overhead expenses, relative to the Taxpayer Services and Enforcement accounts, which are more weighted to payroll expenses. In order to achieve the cost savings, the IRS plans to review existing IT contracts, defer lower priority projects, and incorporate process improvements in non-pay areas.

7. For each of fiscal years 2007 and 2008, how many correspondence audits were conducted of taxpayers with adjusted gross income between $100,000 and $200,000?

8. For each of fiscal years 2007 and 2008, how many face-to-face audits were conducted of taxpayers with adjusted gross income between $100,000 and $200,000?

9. For each of fiscal years 2007 and 2008, how many correspondence audits were conducted of taxpayers with adjusted gross income greater than $200,000?

10. For each of fiscal years 2007 and 2008, how many face-to-face audits were conducted of taxpayers with adjusted gross income greater than $200,000?

Answer: The chart below provides the data requested in questions seven through ten:

		2007	2008
Correspondence	\$100 - \$200K[1,2]	53,272	91,445
Face to Face	\$100 - \$200K[1,2]	37,933	44,041
Correspondence	>\$200K[1]	64,258	80,048
Face to Face	>\$200K[1]	41,291	50,703

Note: (1) Examination measures are in Total Positive Income (TPI), not AGI
(2) Examination does not have a \$100-\$200K breakout – the counts were estimated using the TPI measures for all Activity codes with TPI<\$200K with the TPI >\$99,999.

Questions for the Record from Ranking Member Emerson

Criminal Investigators

Currently there are approximately 2,600 IRS special agents who investigate tax and money laundering crimes involving tax schemes, corporate fraud, non-filers, employment tax fraud, and crimes associated with drug trafficking and terrorist financing. This level is down more than 200 positions from fiscal year 2002. Recently, the Treasury Inspector General for Tax Administration found that in 2008, the number of criminal investigations initiated declined by 11 percent, and the number of criminal investigations completed decreased.

- Why are the number of investigations initiated declining?

Answer: Individual performance numbers fluctuate from quarter to quarter and year to year, and tend to be cyclical since a change in one performance number will affect other performance numbers. The fiscal year statistical table below shows that the number of IRS Criminal Investigation (CI) special agents on board decreased steadily (9.8%) from FY 2002 to FY 2008. During the same time period, cycle time on completed investigations steadily declined (440 elapsed days in FY 2002 vs. 354 elapsed days in FY 2008), demonstrating that CI is operating more efficiently. Increased initiations through FY 2007 and the decline in cycle time contributed to a 26.3% increase in completed investigations as of the end of FY 2008.

The 26.3 % increase in completions over the period FY 2002 to FY 2008 contributed to a 50.7% increase in pipeline inventory at the Department of Justice and U.S. Attorney's Offices over this same period. Preparing the government's case for indictment and trial while providing the taxpayer with due process of law is both time consuming and resource intensive. As a result, CI expended a greater amount of Direct Investigative Time (DIT), an increase of 8.7%, on pipeline investigations in order to ensure successful prosecutions, which in turn generate positive publicity, foster deterrence, and enhance voluntary compliance with the federal tax laws. Increased resources devoted to the pipeline inventory and an overall decrease in personnel left fewer resources to devote to open investigations, resulting in 4.0% fewer initiations and a 16.0% decrease in open subject investigations during the period FY 2002 through FY 2008. While these factors, combined with the overall decrease in personnel, may have temporarily affected initiations, we have already seen an increase in FY 2009.

FISCAL YEAR STATISTICS	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Increase/Decrease from FY 2002 to FY 2008
Initiations	3906	4001	3917	4269	3907	4211	3749	-4.0%
Completions	3201	3766	4387	4104	4157	4269	4044	26.3%
Cycle Time (elapsed days) for Completions	440	398	397	402	398	378	354	-19.5%
SCI Inventory	4395	4615	4136	4283	4034	3981	3691	-16.0%
Pipeline Inventory	2733	3072	3633	3846	3943	4060	4118	50.7%
DIT on Pipeline Investigations	14.5%	15.4%	18.5%	19.0%	21.3%	21.8%	23.2%	8.7%
Special Agents on Board	2902	2800	2797	2830	2804	2684	2617	-9.8%

- Do you need additional criminal investigators?

Answer: Criminal Investigations is seeking additional special agents in the FY 2010 budget request. Pipeline inventory has begun to decrease in FY 2009 (3906 as of second quarter FY 2009). This decrease is expected to free up special agent resources and result in an increase in initiations, open inventory levels, and completions in future periods. However, we are also working with continued attrition of CI's most experienced agents, which may still result in a negative effect on operations. Increasing special agent resources would lead to a greater increase in criminal investigation initiations and completions.

Taxpayer Services

The IRS operates several programs designed to help taxpayers prepare their filings including a telephone service, information provided on the internet, walk-in centers at IRS facilities, a volunteer income tax assistance program, a counseling program for the elderly, and the Taxpayer Advocate Service. Enhanced taxpayer services will improve compliance, reduce the tax gap and improve taxpayers' opinion of the IRS.

- How would the average person learn of these services?

Answer: Information on the various IRS assistance services are provided through multiple channels. These channels include IRS tax packages by mail, IRS publications, IRS.gov, telephone directories, National and local community partners, and both general and targeted IRS outreach activities. For example, taxpayers can learn of the Volunteer Income Tax Assistance/Tax Counseling for the Elderly (VITA/TCE) program through IRS partners, such as nonprofit and business organizations involved in the tax community. Many of our partners market their programs to their communities through the media (television, radio, newspaper, etc.). Many partners advertise for referrals through 2-1-1, a local referral system available to the community for all types of services and assistance. IRS partners often have long standing relationships with the community and often directly refer their clients and their communities to services via verbal and written communications or through fliers, neighborhood canvassing, etc. Information about services such as IRS.gov, Taxpayer Assistance Centers (TACs), VITA/TCE, and the Taxpayer Advocate Service are also found in the IRS's most popular printed products. Publication 17, Your Federal Income Tax-For Individuals, provides more than a page of information promoting IRS services and ways taxpayers may access those services. The Instructions for Form 1040, U.S. Individual Income Tax Return, also advise taxpayers of IRS services. The instructions for Form 1040 are mailed out in the tax packages annually, are available online, and are available through the Tax Forms Outlet Program. For Spanish speaking taxpayers, the IRS published for the first time in 2009, Publication 17SP, Your Federal Income Tax-For Individuals (Spanish Version). Publication 17SP was featured on the Telemundo show, "Los Impuestos y Tu (Taxes and You)" on Jan. 25. As noted above, this publication provides detailed guidance on how taxpayers can access an array of IRS services. This outlet and other communications channels also communicate the availability of Spanish-language telephone assistance and El IRS en Español, our Spanish-language site on IRS.gov.

- Do you use different strategies to promote awareness in rural areas versus urban areas?

Answer: Yes. Unlike urban areas, in which the IRS can utilize mass media and different partner opportunities, the partner standing (or reputation) in a rural community is pivotal to success of the volunteer return preparation program. For example, because of the smaller population and more intimate nature of small towns, partners with an established and trusted status in rural communities can be a key to a word of mouth campaign. An example of this strategy is in providing volunteer income tax assistance to rural villages in Alaska. The regional partner communicates and works with village elders in local communities to ask for their support in delivering services and endorsing the program. The village elder provides an introduction for the VITA program and instills confidence in the residents for using the service. This use of trusted sources within the rural community has been very effective, while the more global media type strategies are more effective in urban areas.

Document Matching

The budget request proposes a $26 million increase to expand document matching to increase the IRS' ability to use automation to match information with the amounts reported on tax returns. This increase is on top of a $35 million increase provided in fiscal year 2009.

- How much enforcement revenue do you raise through using automation to match documents?

Answer: The Automated Underreporter (AUR) program generated $6.4 Billion in assessments in FY 2008.

- How will the $26 million requested increase enhance this program?

Answer: This initiative will increase the coverage of the document matching program and resolve additional mismatches between information reported by third party payers, and information reported by taxpayers on individual tax returns. The initiative will result in the reconciliation of some 261,000 additional tax returns in FY 2010, generating approximately $192 million in additional revenue. Once our new hires are fully trained and reach full potential in FY 2012, this investment will allow IRS to annually reconcile an additional 550,000 tax returns, generating additional revenue of some $387 million each year.

Small Business Compliance

The tax gap is estimated to be $290 billion. I understand that 75 percent of the tax gap is estimated to be associated with small businesses and the self employed. The budget request includes an increase of $94.2 million to improve reporting compliance of small businesses and the self employed. This is on top of a $168 million increase provided in fiscal year 2009 to address the same issue.

- How much non-compliance do you believe is intentional and how much is due to a lack of understanding the tax code?

Answer: We do not have sufficient information from our compliance data (including work done under the National Research Program, or NRP) to determine the extent to which noncompliance is intentional as opposed to arising from misunderstandings. In most cases, there is no objective way to determine the taxpayer's original motivation.

In general, IRS research shows the overwhelming majority of all errors (both in dollars and in frequency) are associated with underreporting. One would expect that truly inadvertent, careless, or innocent mistakes would be made roughly equally in both directions: overreporting and underreporting. In reality, the total amount of understated tax is much greater than the amount of overstated tax, suggesting that this is largely intentional rather than random.

- What are you doing to help small businesses understand the tax code?

Answer: The IRS utilizes a portfolio of services and products to assist small business taxpayers, organizations and professionals in understanding and complying with the tax code. The services and products related to tax law and compliance for small businesses are listed below by stakeholder group.

- Small business taxpayers:
  - e-News for Small Businesses
  - Video and audio presentations for small businesses on irs.gov

- Small Business and Self-Employed Tax Center on IRS.gov
- Virtual Small Business Tax Workshop
- Tax Calendar for Small Businesses and Self-Employed
- SSA/IRS Reporter Quarterly Newsletter
- SBTV.com partnership - internet news channel features IRS news each Wed. and Thurs.
- Electronic FOIA Reading Room
- Freedom of Information Act Requests
- Letter Forwarding Program
- Small Business Workshops

- Tax professionals who are preparers of over 80% of small business returns:

  - Video and audio presentations for practitioners on irs.gov
  - National and Local Phone Forums
  - IRS Stakeholder Partners' Headliners
  - Practitioner Liaison Meetings (PLM'S)
  - Tax Practitioner Institutes (TPI's)
  - Issue Management Resolution System (IMRS)

- Tax professionals and representatives of small business organizations, which include venues to elevate concerns regarding IRS policies and procedures:

  - National and Local Small Business Forums
  - Leveraged Outreach via partnerships with Industry and Small Business Organizations
  - Tax Centers
  - Partnerships with state and local government agencies, state taxing authorities, and other federal agencies

- Congressional offices:

  - Handle non-account related congressional inquiries
  - Deliver information from IRS Legislative Affairs Office (ARRA, filing season info)
  - Provide newsletter with key IRS messages three times a year
  - Coordinate congressional liaison meetings
  - Provide disaster response information

The services and products offered to address language barriers to understanding tax law and compliance are provided in face-to-face meetings with Spanish-speaking tax professionals and representatives of small business organizations:

- Hispanic Small Business Forum required for CA, TX, NY, FL & IL (Adding additional states with growing population)
- Partnership with Hispanic Industry and Small Business Organizations

- Spanish Small Business Tax Centers available in Spanish with a matching template landing page

- When a mistake is found in their return what options do they have to repay their debt?

Answer: It is in the best interest of the taxpayer to pay the tax liability in full to minimize the amount of interest and penalty charged. Payments can be made by credit card, electronic funds transfer, check, money order, or cash. We encourage taxpayers take advantage of the Electronic Federal Tax Payment System (EFTPS) to pay by electronic funds transfer.

Credit card payments are available through two service providers; however the credit card payment service providers will charge a fee for this service. Fees are based on the amount of the payment and may vary by service provider. Taxpayers may initiate a credit card payment by contacting these service providers.

Taxpayer need to consider available options in light of the combination of interest and penalties imposed by the Internal Revenue Code.

If taxpayers cannot pay all their taxes immediately, they have several options, including:

- monthly payments through an Installment Agreement;
- a temporary delay in collection if the case is considered a hardship; or,
- an Offer in Compromise (OIC).

Cap and Trade

If cap and trade or some similar tax legislation related to climate control is enacted, what role will the IRS play in implementing this legislation and collecting climate taxes?

Answer: The role of the IRS would be dependent on whether any proposed legislation affects current tax administration.

Have you estimated how much additional funding the IRS will require in order to implement a cap and trade system?

Answer: The IRS has not estimated the additional funding required to implement a cap and trade system, as the role of the IRS would be dependent on whether any proposed legislation affects current tax administration.

Congresswoman Barbara Lee
Questions for the Record
IRS Hearing on the Budget

IMPACT OF TAX POLICY ON TRENDS IN COMPENSATION

Q1. Can you tell the committee if you believe that the current tax law and the deductibility of complex executive compensation packages either fails to discourage or might even encourage the growth of what some may see as excessive levels of executive compensation?

Answer: Your question raises important issues of tax policy which are properly handled by the Treasury Department's Office of Tax Policy. For your information, I have attached the Statement by Treasury Secretary Tim Geithner on Compensation, which was released on June 10, 2009. The Secretary's statement articulates a set of principles to guide executive compensation policy, raises a number of important questions, and advances several specific legislative proposals as well as other proposed measures.

TAX LIABILITIES OF TARP/TALF BENEFICIARIES

Q2. Can you tell the committee if the Treasury has communicated to the IRS a list of all of the banks, financial services companies and other corporations who have received funds from the TARP or TALF programs or have sold assets to any of the Treasury Programs like the Commercial Paper Funding Facility or mortgage backed securities to Fannie Mae or Freddie Mac?

Answer: We are not aware if any such communication took place.

Q3. Do any of those companies who are benefiting from billions of tax payer dollars and low interest federal loans have any outstanding tax liabilities and are any of those companies being investigated for non-compliance with tax laws?

Answer: The IRS is prohibited from answering this question by the disclosure provisions of section 6103 of the Internal Revenue Code; however, as outlined by section 6103(f), if a Member of a Committee other than House Ways and Means, Senate Finance or Joint Tax seeks this covered information, the Member may submit a written request to the Chairman of his or her chamber's authorizing committee. The written request must specify the purpose for which this return data is sought and conform with the other disclosure provisions of sec. 6103.

RATE OF AUDIT EXAMINATIONS

Q4. Will IRS report back to this committee, the rate at which the largest companies in America are audited each year?

Answer: The largest companies in America are examined by the Large and Mid Size Business (LMSB) operating division. LMSB serves C - corporations, Subchapter S corporations, and partnerships, with assets greater than $10 million.

The rate at which the IRS audited these companies for fiscal year 2008, the most recent completed year for which we have this information, is summarized below. These rates are determined by dividing closures by return filings. Closures represent completed examinations. Return filings represent the total number of returns filed for each return type.

- C - corporations with assets of $10 million to $250 million: 11.5%
- C - corporations with assets of $250 million or more: 26.9%
- C - corporations with assets of $10 million or more: 14.9%
- Partnerships with assets of $10 million or more: 2.4%
- S corporations with assets of $10 million or more: 3.6%
- All large companies (C - corporations, partnerships, and S corporations) with assets of $10 million or more: 6.2%

Q5. Will IRS report to this committee the rates of examination for both individuals and businesses by income levels currently and the rates that IRS hopes to achieve under the President's refocusing of IRS's enforcement efforts?

Answer: The IRS publishes and distributes accomplishment data in the Data Book each year. The last Data Book published was for 2008, wherein the coverage rates by income levels for individuals and businesses are displayed. A copy of Table 9a, which contains the information and level of detail you request, is attached. The results of the President's refocusing of IRS's enforcement efforts will be reflected in the 2009 results and displayed in the 2009 Data Book in a similar manner.

IRS EMPLOYMENT AND CONTRACTING

Q6. Will IRS report to the committee the schools where they perform targeted employee recruitment and outreach, what those efforts entail and if the IRS has a presence at any of the Historically Black Colleges and Universities (HBCU's)?

Answer: The IRS has a three-tiered approach to college recruitment. For over 7000 nationally certified colleges, the IRS maintains electronic marketing (email outreach, job search engines, and college recruitment job board sites), with some increased outreach in years of high volume hiring. The IRS has a more focused marketing effort (media buys in student newspapers, frequent e-mail blasts, relationships with college career counselors, and, in high volume years, increased attendance at job fairs and campus events) at 190 priority schools. The IRS chose the 190 priority schools because they were colleges with diverse representation and identified as top colleges with business, accounting, and/or tax programs, or top-ranked HBCUs/Hispanic American Colleges and Universities (HACUs) based on national rankings, including: The Princeton Review for Top Accounting programs; US News and World Report for all other rankings; the National Center of Education Statistics, and; Integrated Postsecondary Education Data System (IPEDS).

This year the IRS will have even greater efforts concentrated at 90-100 core schools where IRS has been successful in past recruitment efforts, and for which research demonstrated the highest concentration of target skills and largest student bodies with diverse representation. The IRS will have dedicated recruitment teams, including IRS executive sponsors, to develop personal relationships at the school, attend events, and target outreach to student groups and professors.

The IRS currently has recruiting efforts at the following priority HBCU's:

Norfolk State University
Morgan State University
Coppin State College
Bowie State University
Jackson State University
Grambling State University
Philander Smith College
Edward Waters College
Bethune-Cookman College
University of Maryland Eastern Shore
University of Arkansas - Pine Bluff
Huston-Tillison University
Wiley College

Targeted recruitment efforts include expansion to the following core HBCU's:

Tennessee State University
Florida A&M University
Morehouse College
Virginia State University
University of Alabama at Birmingham
Hampton University
North Carolina AT&T
North Carolina Central University

North Carolina State University at Raleigh
Winston-Salem State University

Targeted recruitment efforts include expansion to the following colleges to meet the Hispanic diversity needs:

DePaul
UT - Austin
University of Michigan - Ann Arbor
Michigan State University
Texas A&M University
Pace University
University of California - Santa Barbara
University of California - Riverside
University of California - San Diego
University of Arizona
University of Illinois at Urbana-Champaign
Arizona State University
Stony Brook University
Nova Southeast University
Colorado State University

Q7. When IRS was deciding which schools would have focused recruitment efforts on their campuses, was the disparate presence of women and minorities in certain employment fields and what IRS might do to encourage minority and women participation included in the decision making process?

Answer: In determining the colleges for targeted, focused recruiting efforts, the IRS took into consideration the Equal Employment Opportunity (EEO) data reflecting mission critical occupations, gender and diversity within geographic locations, and matched this data to where the IRS has hiring needs. The IRS incorporated the data into the decision-making process when determining the colleges to select for the highest investment of resources through targeted recruitment with the greatest return on investment. The most acute hiring needs of the IRS could be positively affected through recruitment at those colleges by focusing on the mission critical occupations, the skill sets needed to fulfill those occupations, and gender, EEO and diversity needs.

Press Releases

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FOR IMMEDIATE RELEASE: June 10, 2009
CONTACT: Treasury Public Affairs (202) 622-2960

Statement by Treasury Secretary Tim Geithner on Compensation

For the Say on Pay fact sheet, visit link.
For the Providing Compensation Committees New Independence fact sheet, visit link.

WASHINGTON - Our financial system is built on trust and confidence. It requires rules and practices that encourage sound risk management and align the benefits for market participants with long-term growth and value creation - not only at individual firms, but for our financial system and the economy as a whole.

This financial crisis had many significant causes, but executive compensation practices were a contributing factor. Incentives for short-term gains overwhelmed the checks and balances meant to mitigate against the risk of excess leverage.

Today, I met with SEC Chairwoman Mary Schapiro, Federal Reserve Governor Dan Tarullo, and top experts to examine how we can better align compensation practices - particularly in the financial sector - with sound risk management and long-term growth.
In considering these reforms, we start with a set of broad-based principles that - with the help of experts like those we assembled today - we expect to evolve over time. By outlining these principles now, we begin the process of bringing compensation practices more tightly in line with the interests of shareholders and reinforcing the stability of firms and the financial system.

First, compensation plans should properly measure and reward performance.

Compensation should be tied to performance in order to link the incentives of executives and other employees with long-term value creation. Incentive-based pay can be undermined by compensation practices that set the performance bar too low, or that rely on benchmarks that trigger bonuses even when a firm's performance is subpar relative to its peers.
To align with long-term value creation, performance based-pay should be conditioned on a wide range of internal and external metrics, not just stock price. Various measurements can be used to distinguish a firm's results relative to its peers, while taking into account the performance of an individual, a particular business unit and the firm at large.

Second, compensation should be structured to account for the time horizon of risks.

Some of the decisions that contributed to this crisis occurred when people were able to earn immediate gains without their compensation reflecting the long-term risks they were taking for their companies and their shareholders. Financial firms, in particular, developed and sold complex financial instruments that yielded large gains in the short-term, but still presented the risk of major losses.

Companies should seek to pay top executives in ways that are tightly aligned with the long-term value and soundness of the firm. Asking executives to hold stock for a longer period of time may be the most effective means of doing this, but directors and experts should have the flexibility to determine how best to align incentives in different settings and industries. Compensation conditioned on longer-term performance will automatically lose value if positive results one year are followed by poor performance in another, obviating the need for explicit clawbacks. In addition, firms should carefully consider how incentives that match the time horizon of risks can extend beyond top executives to those involved at different levels in designing, selling and packaging both simple and complex financial instruments.

Third, compensation practices should be aligned with sound risk management.

At many firms, compensation design unintentionally encouraged excessive risk-taking, providing incentives that ultimately put the health of the company in danger. Meanwhile, risk managers too often lacked the stature or the authority necessary to impose a check on these activities. Compensation committees should conduct and publish risk assessments of pay packages to ensure that they do not encourage imprudent risk-taking. At the same time, firms should explore how they can provide risk managers with the appropriate tools and authority to improve their effectiveness at managing the complex relationship between incentives and risk-taking.

Fourth, we should reexamine whether golden parachutes and supplemental retirement packages align the interests of executives and shareholders.

Golden parachutes were originally designed to align executives' interests with those of shareholders when a company is the potential target of an acquisition. Often, they have been expanded beyond that purpose to provide severance packages that do not enhance the long-term value of the firm. Likewise, supplemental executive retirement benefits can make it more difficult for shareholders to readily ascertain the full amount of pay due a top executive upon leaving the firm.

We should reexamine how well these golden parachutes and supplemental retirement packages are aligned with shareholders' interests, whether they truly incentivize performance, and whether they reward top executives even if their shareholders lose value.

Finally, we should promote transparency and accountability in the process of setting compensation.

Many of the compensation practices that encouraged excessive risk-taking might have been more closely scrutinized if compensation committees had greater independence and shareholders had more clarity. In too many cases, compensation committees were not sufficiently independent of management, while companies were not fully transparent in explaining their compensation packages to shareholders. In addition, existing disclosures typically failed to make clear in a single place the total amount of "walkaway" pay due a top executive, including severance, pensions, and deferred compensation.

We intend to work with Congress to pass legislation in two specific areas. First of all, we will support efforts in Congress to pass "say on pay" legislation, giving the SEC authority to require companies to give shareholders a non-binding vote on executive compensation packages. "Say on pay" - which has already become the norm for several of our major trading partners, and which President Obama supported while in the Senate - would encourage boards to ensure that compensation packages are closely aligned with the interest of shareholders.

Secondly, we will propose legislation giving the SEC the power to ensure that compensation committees are more independent, adhering to standards similar to those in place for audit committees as part of the Sarbanes-Oxley Act. At the same time, compensation committees would be given the responsibility and the resources to hire their own independent compensation consultants and outside counsel.

Beyond legislation, I also want to emphasize the importance of the efforts being taken by Chairman Bernanke and the bank supervisors to lay out broad standards on compensation that will be more fully integrated into the supervisory process. These efforts recognize that an important component of risk management is getting incentives right, and we will support the Fed and the other regulators as they work to ensure executive and employee compensation practices do not create unnecessary risk.

Finally, I want to be clear on what we are not doing. We are not capping pay. We are not setting forth precise prescriptions for how companies should set compensation, which can often be counterproductive. Instead, we will continue to work to develop standards that reward innovation and prudent risk-taking, without creating misaligned incentives.

As we seek to strike this balance, the President's Working Group on Financial Markets will provide an annual review of compensation practices to monitor whether they are creating excessive risks. And we will encourage experts in the field - academics, business leaders and shareholders - to conduct their own reviews to identify best practices, emerging positive and negative trends and call attention to risks that might otherwise go unseen.

Many leaders in the financial sector have acknowledged the problems posed by past compensation schemes, and have already begun implementing reforms. But we have more to do to address this challenge, and we look forward to continuing this conversation with a wide range of stakeholders in the weeks and months ahead.

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Table 9a. Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2008

Type and size of return	Returns filed in Calendar Year 2007 [1, 2]	Returns examined in Fiscal Year 2008 [1]			
		Total	Percentage covered	Field [3]	Correspondence
	(1)	(2)	(3)	(4)	(5)
United States, total	**183,052,945**	**1,540,771**	**0.8**	**430,560**	**1,110,211**
Taxable returns:					
► Individual income tax returns, total	137,849,635	[4] 1,391,581	1.0	310,429	1,081,152
▷ Returns with total positive income under $200,000 [5]:					
➢ Nonbusiness returns without earned income tax credit:					
Without Schedules C, E, F, or Form 2106 [6]	78,608,856	342,958	0.4	36,433	306,525
With Schedule E or Form 2106 [7]	15,409,542	205,432	1.3	55,327	150,105
➢ Business returns without earned income tax credit:					
Nonfarm business returns by size of total gross receipts [8]:					
Under $25,000	10,496,414	122,321	1.2	47,146	75,175
$25,000 under $100,000	3,228,160	59,739	1.9	29,133	30,606
$100,000 under $200,000	943,174	36,131	3.8	23,582	12,549
$200,000 or more	730,815	22,869	3.1	20,088	2,781
Farm returns	1,366,833	7,542	0.6	3,608	3,934
➢ Business and nonbusiness returns with earned income tax credit by size of total gross receipts [8,9]:					
Under $25,000	21,028,686	[10] 410,889	2.0	14,130	396,759
$25,000 or more	1,470,688	[10] 51,368	3.5	27,248	24,120
▷ Returns with total positive income of at least $200,000 and under $1,000,000 [5]:					
Nonbusiness returns	2,741,555	72,006	2.6	19,046	52,960
Business returns	1,307,825	36,871	2.8	22,296	14,575
▷ Returns with total positive income of $1,000,000 or more [5]	392,776	21,874	5.6	12,233	9,641
▷ International returns [11]	124,311	1,581	1.3	159	1,422
► Corporation income tax returns, except Form 1120S, total [12]	2,255,443	30,417	1.3	28,373	2,044
▷ Returns other than Form 1120-F [13]:					
➢ Small corporations [14]	2,166,197	20,580	1.0	18,783	1,797
No balance sheet returns	448,117	1,924	0.4	1,843	81
Balance sheet returns by size of total assets:					
Under $250,000	1,137,067	9,073	0.8	7,580	1,493
$250,000 under $1,000,000	366,845	5,030	1.4	4,924	106
$1,000,000 under $5,000,000	182,734	3,585	2.0	3,496	89
$5,000,000 under $10,000,000	31,434	968	3.1	940	28
➢ Large corporations [15]	61,641	9,406	15.3	9,205	201
Balance sheet returns by size of total assets:					
$10,000,000 under $50,000,000	32,697	3,833	11.7	3,778	55
$50,000,000 under $100,000,000	7,629	893	11.7	871	22
$100,000,000 under $250,000,000	7,999	1,026	12.8	1,006	20
$250,000,000 under $500,000,000	4,591	652	14.2	635	17
$500,000,000 under $1,000,000,000	3,350	624	18.6	606	18
$1,000,000,000 under $5,000,000,000	3,950	1,231	31.2	1,197	34
$5,000,000,000 under $20,000,000,000	1,056	678	64.2	652	26
$20,000,000,000 or more	369	469	[16] 127.1	460	9
▷ Form 1120-F returns [13]	27,605	431	1.6	385	46
► Estate and trust income tax returns	3,729,793	4,582	0.1	993	3,589
► Estate tax returns:					
▷ Total	47,298	3,852	8.1	d	d
➢ Size of gross estate:					
Under $5,000,000	38,696	2,182	5.6	d	d
$5,000,000 or more	8,602	1,670	19.4	1,670	0
► Gift tax returns	255,123	1,071	0.4	d	d
► Employment tax returns	30,717,441	60,346	0.2	43,726	16,620
► Excise tax returns	895,388	16,134	1.8	13,477	2,657
► Other taxable returns [17]	[18]	1,943	[18]	1,751	192
Nontaxable returns:					
► Partnership returns	3,146,994	13,203	0.4	10,757	2,446
► S corporation returns [19]	4,155,830	16,634	0.4	15,845	789
► Estate and trust returns	[18]	1,008	[18]	288	720
Income, estate, and gift tax, and nontaxable returns, total	**151,440,116**	**1,462,348**	**1.0**	**371,606**	**1,090,742**

Footnotes at end of table.

Table 9a. Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2008—Continued

Type and size of return	Percentage of returns examined with no change		Recommended additional tax (thousands of dollars)			Average recommended additional tax per return (dollars)	
	Field [3]	Corres-pondence	Total	Field [3]	Corres-pondence	Field [3]	Corres-pondence
	(6)	(7)	(8)	(9)	(10)	(11)	(12)
United States, total	**[18]**	**[18]**	**43,437,364**	**36,729,140**	**6,708,224**	**85,306**	**6,042**
Taxable returns:							
▶ Individual income tax returns, total	11	15	[20] 12,462,770	5,944,735	6,518,035	19,150	6,029
▷ Returns with total positive income under $200,000 [5]:							
➢ Nonbusiness returns without earned income tax credit:							
Without Schedules C, E, F, or Form 2106 [6]	14	22	1,189,047	338,777	850,270	9,299	2,774
With Schedule E or Form 2106 [7]	7	11	893,908	438,591	455,317	7,927	3,033
➢ Business returns without earned income tax credit:							
Nonfarm business returns by size of total gross receipts [8]:							
Under $25,000	7	18	502,902	293,863	209,039	6,233	2,781
$25,000 under $100,000	9	13	531,263	253,957	277,306	8,717	9,061
$100,000 under $200,000	7	14	846,166	511,077	335,089	21,672	26,702
$200,000 or more	13	48	379,659	374,194	5,465	18,628	1,965
Farm returns	15	38	89,282	77,049	12,233	21,355	3,110
➢ Business and nonbusiness returns with earned income tax credit by size of total gross receipts [8,9]:							
Under $25,000	14	7	1,642,114	63,483	1,578,631	4,493	3,979
$25,000 or more	8	14	304,239	240,826	63,413	8,838	2,629
▷ Returns with total positive income of at least $200,000 and under $1,000,000 [5]:							
Nonbusiness returns	14	33	1,502,421	440,885	1,061,536	23,148	20,044
Business returns	16	36	839,476	488,022	351,454	21,888	24,113
▷ Returns with total positive income of $1,000,000 or more [5]	19	55	3,736,403	2,419,572	1,316,831	197,791	136,587
▷ International returns [11]	30	2	5,890	4,439	1,451	27,918	1,020
▶ Corporation income tax returns, except Form 1120S, total [12]	27	78	26,817,682	26,749,498	68,184	942,780	33,358
▷ Returns other than Form 1120-F [13]:							
➢ Small corporations [14]	28	79	601,517	599,509	2,008	31,918	1,117
No balance sheet returns	20	67	86,149	85,816	333	46,563	4,111
Balance sheet returns by size of total assets:							
Under $250,000	26	81	149,272	147,987	1,285	19,523	861
$250,000 under $1,000,000	29	47	132,983	132,656	327	26,941	3,085
$1,000,000 under $5,000,000	33	81	151,527	151,465	62	43,325	697
$5,000,000 under $10,000,000	33	89	81,586	81,585	1	86,793	36
➢ Large corporations [15]	24	69	25,421,905	25,355,729	66,176	2,754,560	329,234
Balance sheet returns by size of total assets:							
$10,000,000 under $50,000,000	32	65	612,758	582,181	30,577	154,098	555,945
$50,000,000 under $100,000,000	32	64	152,612	127,701	24,911	146,614	1,132,318
$100,000,000 under $250,000,000	26	65	347,963	347,797	166	345,723	8,300
$250,000,000 under $500,000,000	22	76	227,306	226,518	788	356,721	46,353
$500,000,000 under $1,000,000,000	20	72	563,489	563,419	70	929,734	3,889
$1,000,000,000 under $5,000,000,000	14	68	3,125,746	3,117,756	7,990	2,604,642	235,000
$5,000,000,000 under $20,000,000,000	6	77	6,233,940	6,232,266	1,674	9,558,690	64,385
$20,000,000,000 or more	4	67	14,158,091	14,158,091	[21]	30,778,459	[22]
▷ Form 1120-F returns [13]	23	98	794,260	794,260	[21]	2,063,013	[22]
▶ Estate and trust income tax returns	14	78	124,244	113,920	10,324	114,723	2,877
▶ Estate tax returns:							
▷ Total	13	0	834,285	d	d	216,697	N/A
➢ Size of gross estate:							
Under $5,000,000	0	0	202,009	d	d	92,665	N/A
$5,000,000 or more	14	N/A	632,276	632,276	0	378,608	N/A
▶ Gift tax returns	26	0	223,537	d	d	208,718	N/A
▶ Employment tax returns	15	3	2,765,036	2,655,818	109,218	60,736	6,571
▶ Excise tax returns	28	55	120,004	118,172	1,832	8,768	689
▶ Other taxable returns [17]	19	41	89,806	89,175	631	50,928	3,286
Nontaxable returns:							
▶ Partnership returns	42	71	N/A	N/A	N/A	N/A	N/A
▶ S corporation returns [19]	34	57	N/A	N/A	N/A	N/A	N/A
▶ Estate and trust returns	52	78	N/A	N/A	N/A	N/A	N/A
Income, estate, and gift tax, and nontaxable returns, total	**14**	**16**	**40,462,518**	**33,865,975**	**6,596,543**	**91,134**	**6,048**

Footnotes at end of table.

Table 9a. Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2008—Continued

Footnotes

d—Not shown to avoid disclosure of information about specific taxpayers. However, the data are included in the appropriate totals.

N/A—Not applicable.

[1] Excludes excise tax returns filed with the Customs Service and the Alcohol and Tobacco Tax and Trade Bureau, and returns of tax-exempt organizations, Government entities, and employee plans.

[2] In general, examination activity is associated with returns filed in the previous calendar year.

[3] Field examinations are generally performed by revenue agents, tax compliance officers, tax examiners, and revenue officer examiners, in person or through correspondence (in selected cases).

[4] Includes a total of 503,755 returns with an earned income tax credit (EITC) claim. These returns were selected for examination on the basis of an EITC claim or other selection criteria. Excludes 4 returns associated with the earned income tax credit qualifying child certification test, which are tracked in IRS's examination database.

[5] In general, total positive income is the sum of all positive amounts shown for the various sources of income reported on the individual income tax return and, thus, excludes losses. Examinations of individual income tax returns are shown in this table by total positive income of: under $200,000; at least $200,000 and under $1,000,000; and $1,000,000 or more.

[6] Includes Forms 1040 without a Schedule C (nonfarm sole proprietorship), Schedule E (supplemental income and loss), Schedule F (profit or loss from farming), or Form 2106 (employee business expenses).

[7] Includes Forms 1040 with a Schedule E (supplemental income and loss) or Form 2106 (employee business expenses). Excludes returns with a Schedule C (nonfarm sole proprietorship) or Schedule F (profit or loss from farming).

[8] "Total gross receipts" is the sum of gross receipts from farm and nonfarm businesses. It is calculated by adding the positive values of gross receipts and other income from Schedule C to the cost of purchased items and gross income (which can be positive or negative) from Schedule F. Schedule C is used to report profit or loss from nonfarm sole proprietorships. Schedule F is used to report profit or loss from farming. If a taxpayer reports both farm and nonfarm income, the return is classified by the larger source of income.

[9] Includes all Forms 1040, those with and without business income, reporting an earned income tax credit claim. These returns are classified by size of total gross receipts. Business returns have total gross receipts reported on Schedule C (nonfarm sole proprietorship) or Schedule F (profit or loss from farming). Nonbusiness returns, those with no Schedules C or F, are reported in the "Under $25,000" classification.

[10] Includes returns selected for examination on the basis of an earned income tax credit (EITC) claim.

[11] Includes Forms 1040PR (self-employment tax form for Puerto Rico) and 1040-SS (self-employment tax form for U.S. Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands).

[12] Includes Forms 1120 ("long form"); 1120-A ("short form"); 1120-F (foreign corporation, except foreign life insurance company); 1120-H (homeowner association); 1120-L (life insurance company); 1120M (mutual insurance company); 1120-PC (property and casualty insurance company); 1120-POL (certain political association); 1120-REIT (real estate investment trust); 1120-RIC (regulated investment company); and 1120-SF (settlement fund). Excludes certain other types of corporations, which are included in "other taxable returns" described in footnote 17.

[13] Form 1120-F is filed by a foreign corporation with U.S. income, other than a foreign life insurance company (Form 1120-L) or a foreign sales corporation (Form 1120-FSC).

[14] Includes returns with assets of less than $10 million examined by either the Small Business/Self-Employed Operating Division or the Large and Mid-Size Business Operating Division.

[15] Includes returns with assets of $10 million or more examined by either the Small Business/Self-Employed Operating Division or the Large and Mid-Size Business Operating Division.

[16] The percentage of returns examined may be greater than 100 percent of the returns filed in Calendar Year 2007 since examinations may be conducted on returns filed in prior calendar years.

[17] Includes Forms 1120S for an S corporation reporting a tax (see footnote 19); 1120-FSC (foreign sales corporation); 8288 (withholding tax return for disposition by foreign persons of U.S. property interests); 990-C (farmers' cooperative association); and 8804 (partnership withholding).

[18] Not tabulated.

[19] Includes most Forms 1120S, which are filed by qualifying S corporations electing to be taxed through shareholders. Under certain conditions, S corporations are subject to tax and are included in "other taxable returns" in this table. See footnote 17.

[20] Includes a total of $1,993,891 (thousands) in recommended additional tax (including an earned income tax credit) on returns selected for examination on the basis of an EITC claim or other selection criteria. Excludes $7 (thousands) in denied EITC related to the qualifying child certification test. These EITC cases are tracked in IRS's examination database.

[21] Less than $500.

[22] Less than $50.

NOTE: Detail may not add to totals because of rounding.

SOURCE: Small Business/Self-Employed, Examination, Examination Planning and Delivery, Examination Management Information Systems and Automation SE:S:E:EPD:MISA

WEDNESDAY, MAY 20, 2009.

OFFICE OF MANAGEMENT AND BUDGET

WITNESS

PETER R. ORSZAG, DIRECTOR

Mr. SERRANO. The subcommittee will come to order. We apologize for the delay. We were on the House floor voting on the credit card bill that had a gun in it. It is very strange; I don't know if that means from now on, when you go to an ATM machine, you need to be packing.

Mrs. EMERSON. It is just Federal parks, Joe.

Mr. SERRANO. Oh, I see, only for Federal parks.

We welcome you to our annual hearing with the Office of Management and Budget. We again apologize for the delay.

OMB, of course, plays the lead role in formulating the President's budget, which we spend so much time studying and debating. On that subject, I would like to say how refreshing it is that this year's budget gives the Appropriations Committee some fairly realistic numbers to work with rather than continuing the previous approach of pretending that we don't need to adequately pay for all the important things the government does in areas like public safety, education, science, and health.

But while OMB does the Nation's budget, we do OMB's budget, which is one of the reasons we are having this hearing today.

Last year we decided it was time to help OMB out a bit. Over the years their funding has not kept up with rising costs, and as a result, the size of the OMB staff has been shrinking. In the 2009 appropriations bill we tried to help reverse that trend by adding money to restore some staff and also to deal with problems in OMB's computer system. At today's hearing we will be interested in learning how OMB is using those funds.

Our subcommittee also crosses paths with OMB in the general provisions carried out in our bill dealing with matters of government-wide policy. For example, one issue that we have been concerned about is the rapidly rising volume of government contracts as the previous administration increasingly turned to private contractors to take over functions previously performed by public employees. Some of that activity may have been beneficial, but much of it has been wasteful, inefficient, and demoralizing to the Federal workforce.

Further, far too many contracts are being awarded without full and open competition. And there has been inadequate management and oversight to make sure that contractors actually perform and provide good value.

To help deal with these problems, we have been carrying various requirements and restrictions in our annual bill, and we are gratified to see that policy change is on the way in the executive branch as well. President Obama has asked the OMB Director to study various issues regarding Federal procurement in cooperation with other senior government officials and to make recommendations for change. We look forward to the results of that effort.

OMB also deals with government-wide policy in a number of other areas, including the regulatory process, information, technology, and statistical policy. We are likely to explore some of these areas in the course of this hearing.

Our witness today is Peter Orszag, who was appointed Director of OMB by President Obama. Dr. Orszag is an economist by training. During the Clinton administration, he served as Special Assistant to the President For Economic Policy and in various positions at the Council of Economic Advisors. He has been a Senior Fellow and Deputy Director of Economic Studies at The Brookings Institution and, most recently, has worked in the legislative branch as Director of the Congressional Budget Office during '07 and '08.

Welcome, Dr. Orszag.

And we really do welcome you to today's hearing. I must say that in reading some things about you, I should have been impressed, but I was troubled by the fact that while I try to run at 7:15 in the morning, you run at 6:00. And you should never try to—take advice from Mayor Fenty. Every time I see him running or he sees me running, he slows down to make it look like I am fast because he knows who handles his budget.

So if you see me out there, just look like you can't keep up with me. I would appreciate that.

But welcome today. And I turn now to my colleague and friend, Jo Ann Emerson, from St. Louis Cardinal territory.

Mrs. EMERSON. St. Louis Cardinal territory it is, but I am very pleased, Director Orszag, to know that you are a Toby Keith fan, and so am I. As a matter of fact, I recently went to one of his concerts with some radio guys from my district. It was quite interesting, but it was lots of fun.

Anyway, I can't begin to tell you how much we appreciate the hard work that your staff of, what, just about 500 does, and the dedication that all of you have in serving the American public. It is not an easy job, and obviously you are always made out to be the bad guy—by us appropriators, particularly—but nonetheless, thank you. Because of those enormous responsibilities that you all have in assisting the President—any President, Republican or Democrat—it is very important that we give you the tools you need to do your job, and I am very appreciative.

However, I am also, and it would be expected, I think, of my party that I am not too excited about the Federal budget for fiscal year 2010. I know that the American public knows how tough things are, and they also believe, at least my constituents believe, in shared sacrifice.

But I can't tell you—every time I am home they want to talk about the budget and the, you know, $1.84 trillion projected deficit for 2009 and those deficits well into the future. And when I say, well, in the tenth year things will go down to, you know, the billions, they look at me and they just can't comprehend that.

So this is worrisome. It is worrisome to me. It is worrisome to my very frugal constituents who are not at all wealthy. As a matter of fact, I have the 20th poorest district in the country. But nonetheless they are very worried, and they ask me all the time, Where are we borrowing this money from, China or Saudi Arabia, even sovereign wealth funds. So I am worried that this public borrowing will crowd out investment in the private sector, which could potentially slow recovery.

They are asking me who is going to ultimately pay for this borrowing; is it our children, our grandchildren, or their grandchildren? And what will this budget do to the country's long-term health? Are any tough funding choices being made?

And I know it is not easy. So while we may not agree on all of the budget policies, I really do recognize the challenges that you all face, and I hope that you know that we want to work as closely and as collaboratively as we possibly can.

So thanks so much for being here.

Mr. SERRANO. Thank you.

Just for the record, she mentioned 20th. I represent the poorest congressional district in the Nation, located within the richest city on Earth, within walking distance of the wealthiest congressional district in the Nation, which is the East Side of Manhattan. My constituents don't like to get into that either, but they know that spending money on education and health care and making their lives a little better is a good expenditure. So they are as frugal as anybody else, but they also know that government can't stay totally away from their future.

We once again thank you. We ask you to keep your testimony down to 5 minutes. Your full statement will go in the record and that will give us time to grill you to death before us today.

Mr. ORSZAG. Thank you very much, Mr. Chairman, Mrs. Emerson, members of the committee.

Actually, before I begin, let me just say two things briefly. One is with regard to running. I did make the mistake of going running with Mayor Fenty and realized after 2 or 3 minutes my sole objective was not to come in last because they are way too fast.

In September, I will be attending the Toby Keith concert at the Nissan Pavilion. So maybe we can get together to go out and listen to Mr. Keith.

Thank you very much for having me here today. We did important work together with regard to the Recovery Act to get the economy back on the path towards economic growth, and there is much more to be done.

The fiscal year 2010 budget, overall, is intended to move the economy, help push it out of the worst recession that we have experienced since the Great Depression and bring down medium-term and long-term deficits. We do that by investing in key areas like in education and clean energy, and in—especially with regard to the fiscal path that we are on, I have said repeatedly that the most important thing we can do is bring down health care costs. If health care costs over the next four decades grow at the same rate as they did over the past four, Medicare and Medicaid will go from 5 percent of the economy today to 20 percent by 2050. That is unsustainable and that needs to be changed, and changing that has to be at heart of our health care effort this year, working with you.

I could go on about education and clean energy, but perhaps we can leave that for the question-and-answer period and just turn to the work that OMB does.

One of the things that we are trying to accomplish is putting a significant emphasis on evidence-based policy making, looking at specifically what works and what doesn't. I was particularly heartened by the fact that the Coalition for Evidence-Based Policy recently commended the administration for emphasizing evidence in making our decisions; and I would be happy to talk about, for example in education, the way that we are trying to reorient some of the programs that have been demonstrated not to work as well towards those that do to get as much as we can from taxpayer dollars.

Part of what we are trying to do also involves managing the Federal Government better. The President has put forward and nominated Jeff Zients as his first Chief Performance Officer and Deputy Director for Management at the Office of Management and Budget. If he is confirmed, he will lead the overall administration effort in trying to make government work better. And that has multiple components; a key component is improving and motivating the quality of the Federal workforce.

This morning I attended the award ceremony for the best places to work in the Federal Government. I was very pleased that OMB and CBO, they actually tied for third, which is good. We are going to look to beat the tie next year.

But there is much that can be done to promote the Federal workforce, because that is at the heart of what we are trying to do. And that speaks in part to contracting, it speaks to acquisitions. It is very difficult to get anything done in government without a high-performing workforce.

So we have a robust agenda to try to shorten the hiring process, provide better training, provide better mentoring, provide better incentives for high performance, working with John Berry, who heads up the Office of Personnel Management.

There are other components to the management agenda which I could speak to also, but let me, in my brief remaining time, turn to OMB itself.

OMB could not succeed without its cadre of highly qualified and just outstanding staff, but in recent decades OMB has taken on more responsibilities including in financial management, procurement oversight, E-Government, to name just a few.

Staffing levels have actually steadily declined. If you look at around 1990, for example, OMB staffing was in excess of 600 budgeted full-time equivalent staff. By 2008, budgeted staffing levels had fallen to 489, and this was during a time in which OMB was asked to do more.

As the chairman already noted, in the fiscal year 2009 budget appropriations, Congress recognized that staffing at OMB had become insufficient; and we appreciate the funding that you provided that will allow us to raise our staffing to 528 FTEs, still significantly below where we were 20 years ago, but nonetheless above where things had been in 2008, for example.

Largely as a result of annualizing the cost of those additional FTEs, the President's budget requests $92.7 million for OMB in fiscal year 2010. So I thank the subcommittee for having funded the additional staffing in the fiscal year 2009 appropriations cycle. I believe it represents an important investment in being able to make government work better and look for more effective programs; and I look forward to working with you. I hope you will fund the 2010 request at the level that we have submitted.

And I would welcome your questions. Thank you.

Mr. SERRANO. Well, thank you.

In 2009, this subcommittee provided OMB with a $10 million increase, a decision made before you took office. What priorities have you set for using that increase and why? To the extent you are using the funds for increased staff, what functions within OMB would the additional staff be assigned to?

Mr. ORSZAG. The majority of the increase does go for additional staff, as I just mentioned. That reflects the decline that had occurred, and I think, coming into OMB, a clear need for additional staff in some areas.

One of the changes we made, for example, was to create—recreate what had existed during the 1990s, which is a PAD, or Principal Associate Director for Health Care, given the importance of health care policy not only this year but on an ongoing basis. So one important area is health care.

But, in addition, I mentioned Jeff Zients, who will be the Deputy Director for Management. We have some additional staffing on the management side of things, even though I don't like that separation between budget and management. If you just look at the org chart, at least, on the management side there are additional staffing.

The majority of the additional funding went for personnel, which is not surprising given that roughly 80 percent of OMB's overall budget goes for personnel. That is also where we put the bulk of the additional resources. But in addition to that, there was funding provided for some additional improvements to the MAX system, which is the computer system that we use for budgeting, and other IT investments including in a—I have to say there was a mixed reaction to requiring OMB staff to have BlackBerrys so that we could reach them all during—any time of the day or night.

Mr. SERRANO. Maybe they can give us their pin number so we can reach them.

So obviously there is going to be an emphasis on the health care issue, government-wide actually, but certainly at OMB.

Mr. ORSZAG. Absolutely. I would say I am personally probably, depending on the week, spending a half to two-thirds of my time on health care right now.

Mr. SERRANO. You mentioned MAX system. What else can you tell us? How much of the 2009 appropriation are you using for that and where are we at?

Mr. ORSZAG. Sure.

Of the 2009—let me just give you—in total, the MAX funding for fiscal year 2009 was $4.1 million. There was some additional funding that is being provided, $435,000, in fiscal year 2009, so that would bring the total to about 4.5.

Let me just say, there is a strategic question that we are working our way through with regard to upgrading and improving the MAX system. One of the complaints that I get from OMB staff and from agency staff is—involves the operations of the MAX system. So we are in the process of evaluating the best way forward in improving it.

Mr. SERRANO. Well, our information is that it is over 20 years old; is that correct?

Mr. ORSZAG. It is old, yes. I can't give you the exact date. I may be able to get it, but it is something like 20 years old, yes.

Mr. SERRANO. You buy a computer, and a couple years later it is not working properly. So how the heck did you get all those numbers? Was that the reason why we were saying throughout the year that those numbers were not correct?

Mr. ORSZAG. Well, it is an old system. It still works. I think the issue is not whether it works or not, but rather how cumbersome it is and whether it could be made more efficient. And so one of the complaints that is issued is just how long it takes to enter things into the MAX system, that it is not as effective as it could be in—so it is not a question of sort of quality or accuracy. It is more, I think, a question of degree of difficulty of inputting and processing the information.

Mr. SERRANO. In addition to your regular budget request this year, the President's budget is seeking 1.75 million for a Partnership Fund for Program Integrity, which would be administered by OMB. What is the purpose of that fund and how would it be used?

And under the partnership proposal it looks like OMB would actually be administering a substantial grant program. Is it appropriate for OMB to be running programs itself? Does OMB have the expertise to do so?

Mr. ORSZAG. No. And we won't. So let me try to be clear about what this is intended to do and how it would be administered.

There are many government programs that are the joint responsibility of the Federal Government and State and local governments. Consider Medicaid, for example. The SNAP program, which used to be called food stamps, has some joint Federal-State roles also in terms of processing applications.

One of the problems that we have is, because of the lack of adequate IT infrastructure in many States, someone applying for this program, information about that person, may not be usable for some other program. What we are trying to do is see if we can become more effective. This is a general theme, making sure that the right person gets the right benefit at the right time and not otherwise.

If you are on this system and you don't qualify for this benefit, then we need to be able to kind of crosswalk that better. And similarly if you are over here and it does look like you qualify for this other benefit, we might want to notify you of that.

What we are trying to do through this program is conduct some pilot projects that would allow better IT integration across different platforms, across different programs. So what will happen is, these pilot projects would be administered by agencies.

We will not be administering them. But in the examples I was just giving, either HHS or the Department of Agriculture, or you can imagine the Department of Labor in other settings, administering a grant for a pilot project to see if we can better integrate and provide an IT backbone for some of the programs that are the joint responsibility of the Federal Government and the State government. Our role would just be to help evaluate the submissions for those pilots, the sort of grant applications, if you will.

Mr. SERRANO. So it would be clear to us that you would not be running a grants program as such.

Mr. ORSZAG. No. The grants pilot programs—the grant would run from a Cabinet agency with a State or locality. We would play some role in helping to choose which pilot projects to fund.

Mr. SERRANO. Thank you.

Mrs. Emerson.

Mrs. EMERSON. Thank you, Mr. Chairman.

I am going to ask you a policy question. I will get to the other issues, budget issues afterwards.

Recently you made three points that health care—on health care reform, one, that health care reform would have to be deficit-neutral, self-financing, and work to keep the overall costs of care low. I think you said, quote, "You are not going to see a deficit increasing health care reform."

In the House, I am actually working on several different reform measures including a program to initiate tax credits for insurance expenditures up to about $17,000 for a family of four. And obviously any plan that requires a personal mandate for health insurance, with which I agree, or a public option that gets the Federal Government into the insurance business, with which I don't agree, at least at this moment in time, is going to cost the taxpayers money.

I also appreciate the fact that the various stakeholders in the health care system have come to the White House offering concessions, which you all ball-park at about $2 trillion, I think. I also appreciate the fact that you all have budgeted for a down payment on reform of about $634 billion. But I don't see that down payment, if you will, being part of a self-financing health care reform because the savings aren't necessarily going to be taken from the health care system, with perhaps the exception of Medicare Advantage.

So my first question is, why does a self-financing health care reform require a $634 billion down payment from the U.S. taxpayer, who has seen no reform in the system to this point? First question.

Second, can you tell me how the administration plans to control costs in the private sector despite the serious problem of medical inflation which, outside the scope of Medicare and Medicaid, has a particularly severe effect on America's seniors? And if the big pharmaceutical companies and insurance giants can afford to voluntarily offer $2 trillion in savings—which, to me, should really be about $3 trillion—as a consequence of just being asked, doesn't that signal then the existence of other meaningful regulatory reforms that could be achieved in Medicare and Medicaid?

So what measures are you all taking to create savings in existing government health care programs without cutting benefits to citizens and seniors?

And last, how do you—this is the part that is probably the most complex. How do you plan at OMB to measure the savings generated by the private sector for Medicare and Medicaid and other government programs, whether it is SCHIP or the like, in an effort to leverage health care reforms? And how are we going to hold the private sector to its commitments?

I am sorry. There are several questions.

Mr. ORSZAG. That is okay. Thank you. Let me try to answer that in two steps.

The first involves whatever happens within the next 5 or 10 years within the Federal budget. We have been clear that over the next 5 or 10 years we are insisting that health care reform be deficit-neutral with hard, scorable savings—that is, with savings that, for example, CBO would score, including through changes to Medicare Advantage, but including through changes in reimbursement rates for hospital readmissions and home health agencies and a whole host of other proposals that we have put on the table.

The second piece involves changes that we call "game changers," changes in the way that health care is practiced in the United States that are unlikely to be scored by CBO, but that are crucial to, A, the long-term fiscal path that we are on, and B, that require the involvement of the private sector in order to work.

So what do I mean by that? I mean four things in particular.

And let me back up. We have huge variation across the United States in health care costs for a beneficiary that you can't explain, based on——

Mrs. EMERSON. Region.

Mr. ORSZAG. Across regions, across hospitals within a region, across doctors within a hospital, which is perpetuated by a lack of specific information about what is best for a particular patient, and a payment system that just says always do more rather than do better.

So what do we need to change? We need health information technology so that we reduce redundancy and we eliminate the need to fill out that form every time you go to a doctor. We need more research into what specifically works, so your doctor is armed with better information. We need prevention and wellness so that we are oriented towards health and not just health care. And, by the way, all three of those steps were—there was significant progress made in the Recovery Act.

And, finally, we need changes in financial incentives so that hospitals and doctors are not penalized for more effective care. That is what happens today. If you have a hospital that is really good at avoiding readmissions, for example, they are financially penalized relative to some other hospital that is not as good as that, which makes no sense.

So what we are trying to do is in the first case, hard, scorable savings; and in the second case, change the set of incentives in the way that health care is practiced, so that we get to a more efficient system, because there are so many indicators that substantial efficiency improvements are possible. To do that second piece, you need the private sector involved.

And that was what was so significant, I think, about what happened last Monday, which was that you had insurance companies, doctors, hospitals, device manufacturers, pharmacists saying, Yes, we can get more efficiencies out of the health care system. That will be crucial to helping to drive down premiums for consumers and sustaining the changes in Medicare and Medicaid, because if we just ramp down Medicare and Medicaid growth over here and the underlying rate of health care costs continue unabated, these changes would not be sustainable.

Mrs. EMERSON. With regard to administrative costs for the insurance companies, can you actuarially—I mean, do you know how much padding is in, on average, the 21 percent overhead costs that is claimed today?

I mean, is there a way to get at that, so that if you have insurers saying, We will do a guarantee issue, we will have maybe a community rating, blah, blah, blah—all of which will help get costs down, because you can expand the number of people who are insured; but it is that administrative cost that is kind of tough to pinpoint.

Is there a way to get at that?

Mr. ORSZAG. Well, there have been some attempts. The McKinsey Global Institute, for example, tried to examine the administrative loadings or the administrative costs in our system relative to the other systems, to see what the differential is.

One of the complexities, just for whatever it is worth, is, many of the things—for example, I mentioned prevention and wellness. Some of the things that insurance companies do to promote prevention and wellness will count as administrative costs in a sense or as nonmedical loss expenditures, which is typically what the category of administrative costs include.

So, there is an example of—I don't know that we would want to be discouraging that kind of cost as opposed to unnecessary duplication and lack of the complexity in forms and what have you.

So I think that is the challenge. But it is clear that there are efficiencies that are possible, which is why the insurance association, AHIP, was part of that group last Monday and said, "Yes, we can do better on our internal administrative costs."

Mrs. EMERSON. Well, and even, you know, we have been able to get the administrative costs for crop insurance down substantially in the last 4 or 5 years. So, I mean, there is wiggle room.

And one final question on this. Is it conceivable or can you score—maybe this is a better way of putting it—if, in fact, we took all Americans, regardless of whether they are Medicare, Medicaid, whether they are dual-eligible, whether they are uninsured, underinsured, we took all Americans and put them together in a plan like the Federal Employee Health Benefits Program and gave options—and, obviously, one would be okay for everybody, and then you could buy up—I mean, would that not be less expensive overall, perhaps, than having different types of programs and creating disparities? Like, if you have Medicaid, obviously Medicaid, for a lot of people, isn't nearly as good as our basic BlueCross BlueShield. I mean, is it possible to even figure out how much something like that would cost?

Mr. ORSZAG. Yes, it is possible. I mean, there are a couple of different dimensions to that. One is whether the individuals already have coverage and you are picking up additional costs, so there is sort of a displacement effect. The second is administrative savings from unifying and getting economies of scale into—you know, you put more people into a plan, the cost per beneficiary of fixed overhead can be lower.

Although, the evidence suggests that you reach an efficient scale pretty quickly, so it sort of flattens out, and there is probably not—at level of the size of things like Medicaid, there is probably not very much additional efficiencies that are possible.

Mrs. EMERSON. Okay. All right. I appreciate that. Thanks.

Thanks, Mr. Chairman.

Mr. SERRANO [presiding]. Thank you.

We will now begin our questioning under the 5-minute rule by members of the committee. And we will first go to the gentleman from Pennsylvania, Mr. Fattah.

Mr. FATTAH. Thank you, Mr. Director.

Now, the budget that OMB produced this year was $3.6 trillion. What was the budget last year? $3.1 trillion?

Mr. ORSZAG. Well, actually, it depends exactly how one does the calculation. But it was actually, for fiscal year 2009, $4 trillion, under our proposals. Under current laws, $3.8 trillion.

Mr. FATTAH. Okay. And, well, you added in the costs for the war effort, so you took that off the—rather than go through the supplemental route, which became the normal way to proceed, those costs are now included in the budget?

Mr. ORSZAG. Correct.

Mr. FATTAH. And you also included other items that somehow have been listed in supplemental efforts in the past, including responses to weather, hurricanes and the like, right? So you put those in, and that was preferable because it gives a better sense of what the real spending of the needs of the government may be, right?

Mr. ORSZAG. Correct.

Mr. FATTAH. Now, you also set aside—is it $636 billion for health care, this downpayment?

Mr. ORSZAG. $635 billion.

Mr. FATTAH. $635 billion. So when this final proposal comes forward, you expect that, even if it costs more or costs less, that you have at least allotted some dollars to try to phase in a health care solution?

Mr. ORSZAG. Well, yes. And, in particular, that was intended to be a downpayment on whatever the ultimate reform looks like. We have been clear, though, that, to the extent that the ultimate reform involves any additional costs beyond that, they will need to be offset through either savings within the health system or revenue from outside the health system.

Mr. FATTAH. Now, inside OMB and your budget, as you allocate your 500-plus employees—you talked about the percentage of your time focused on health care. What percentage of this FTE complement is focused on health care now?

Mr. ORSZAG. I will look it up in a second, but it is more evenly distributed than my own time. And that is, frankly, the way it should be, because we have lots of other things going on at the same time. And while I can swing from one area to another quickly, it is hard to take a health analyst and put them on, you know, the defense budget.

So the allocation, though, in particular for fiscal year 2009, on health programs, we have roughly 50 staff. And that is, again, pretty evenly deliberated across national security, general government, natural resources, education, and then there are a few other offices. But in health care we have about 50 people.

Mr. FATTAH. Now, it may be difficult for you to, as you go forward, to rationalize some of the critics—you know, I noticed when the $100 million savings was announced, people said, "Well, that is nothing." And then you got to the $17 billion, and they said, "Well, that is a drop in the bucket." And then the health care announcement last week of $2 trillion in savings over 10 years from the various participants, people said, "Well, somehow it is still—you know, we are not on target." It is kind of a moving target around here.

But what is important, I think, from the committee's standpoint, is to make certain that you have the resources at OMB to do the work that you need to do. And your budget calls for a small increase, 4 or 5 percent?

Mr. ORSZAG. Five percent, yes, sir.

Mr. FATTAH. Five percent. But at the same FTE complement as last fiscal year?

Mr. ORSZAG. Yes. And, indeed, a bulk, a significant part of the requested increase takes—the fiscal year 2009 appropriations was passed in the middle of the fiscal year, and so we need to annualize the costs of the additional FTEs. And so a significant chunk of the increase from 2009 to fiscal year 2010 request reflects that annualization process.

Mr. FATTAH. Right. Well, my only point is that, given the effort of the administration on a number of fronts, obviously it creates a significant challenge for OMB.

Mr. ORSZAG. Yes.

Mr. FATTAH. And, you know, the job of our committee is to make sure that you have the resources you need to serve the country and to serve the administration in the vital role that OMB plays.

Mr. ORSZAG. I appreciate that. I would come back again, this morning, on the best places to work in the Federal Government, we did very well, ranked third overall. But on work-family balance, we were not so good. So, you know, the folks at OMB are working very hard.

Mr. FATTAH. Well, I want to thank the chairman, but I think the chairman's question about your 20-year-old computer system illustrates some of the concerns. And as we deal with health care and energy and balancing this budget and tax reform, which is also on the President's agenda, we want to make sure that you have all the resources that are necessary.

Mr. ORSZAG. I appreciate that. Thank you.

Mr. FATTAH. And I have one question for the record on one of your program integrity efforts around erroneous payments, and I will submit that for the record, and I would like to get a response.

Mr. ORSZAG. Sure, of course. Thank you.

Mr. FATTAH. Thank you.

Mr. SERRANO. Mr. Culberson, the gentleman from Texas.

Mr. CULBERSON. Thank you, Mr. Chairman.

I appreciate your testimony here, Director. And, of course, the committee is going to do everything we can to help support the work of OMB. But I want to focus, if I could, your attention on what David Brooks on Friday in his column called approaching financial national suicide.

In my opinion, the administration is not being realistic. And, by the way, I don't play favorites here. I voted against $2.3 trillion worth of spending under President Bush. I represent his parents. And I have voted against $1.6 trillion in spending so far under this administration.

I am deeply concerned, as Mrs. Emerson's constituents are, with the financial path the country is on. And I, frankly, don't see the estimates coming out of OMB as being grounded in reality. To have, for example, the President's—where did I see that? You all's budget this year, I think your term for it was that—I am sorry, I don't have it right in front of me, but you would refer to the President's budget this year as trying to return to being responsible. Yet the deficit that we are running is at record levels. It looks like, this year, OMB just increased your budget deficit estimate this year to $1.8 trillion. Estimates are that it is going to stay over a trillion dollars for the foreseeable future.

We, according to David Walker, the comptroller of the currency—and I mean this very sincerely—this is not—I mean, forget—I have actually quit referring to the political parties. I would like to focus on what is fiscally responsible and what is fiscally irresponsible. And I really believe that we really need a little bit of Dave Ramsey in the way that the Federal Government approaches things and do everything we can to save money, even if it is a little bit at a time.

And I really wanted, if I could, Mr. Chairman, to have the director talk to us about what the administration intends to do to try to—for example, let's take one bite at a time. Medicare, the trustees tell us, is out of money in 2017. That is only 8 years away. Bankruptcy, there is no more money, no more checks.

What is the administration specifically proposing to do to prevent Medicare from becoming bankrupt in 8 years?

Mr. ORSZAG. Several things.

First, we have already put forward in the budget—there was reference before—more than $300 billion in Medicare and Medicaid savings, including roughly $175 billion in Medicare Advantage savings, which would help to extend the life of the Part A trust fund to which you were referring.

More important than that, though, is, if you look out over time, nothing else that we could possibly do will matter as much as whether we can reduce the rate at which health care costs per beneficiary are growing relative to income per capita, which has averaged 2 to 2.5 percentage points per year. If we can get that down to 0.5 or 0.75 or 0.25 or something significantly below its historical level, that has such monumental effects.

So, for example, Medicare and Medicaid savings in 2050, if you reduce the growth rate by 1.5 percentage points per year, which is difficult to do—it comes back to some of the things we were talking about—but if you succeeded in doing that, gets reduced by 10 percent of GDP.

Mr. CULBERSON. Right, but we may not even get there. I am talking 8 years. This is, like, immediate. What do you recommend we do in the next——

Mr. ORSZAG. Well, again, we have put forward $177 billion in Medicare Advantage savings, significant additional savings in Medicare, and then more that will be part of an overall health care reform effort. That is moving the trust fund in the right direction.

Mr. CULBERSON. So you believe, if we adopted—let's just say, for the sake of argument, that Congress adopted all of those proposals, Medicare will not be bankrupt, then, in 2017?

Mr. ORSZAG. No, it would extend the life of the trust fund by a couple of years. More important than that is to reduce the long-term growth rate. If——

Mr. CULBERSON. Bankrupt in 10 years?

Mr. ORSZAG. Just to give the number for a second, if you reduce the growth rate by 1.5 percent per year, you reduce the long-term imbalance in Medicare by two-thirds. It doesn't eliminate it; there is more that would need to be done. But you would reduce the long-term imbalance within Medicare by two-thirds, which is the key fiscal problem that we face.

Mr. CULBERSON. That is the long-term outlook. So you think you would extend the bankruptcy by maybe—prevent it by about 2 years?

Mr. ORSZAG. If you then also build in slower growth rate in health care costs overall, which would help on Medicare and Medicaid, it is an additional couple of years.

Mr. CULBERSON. Do you disagree with—and my time is limited—David Walker, who is the comptroller for the United States, our auditor until about 18 months ago, is now head of the Peterson Foundation because he got so concerned. And this is really straight from my heart, and party labels are irrelevant when it comes to protecting the country's solvency. Moody's has now warned us formally that we could lose our AAA bond rating. That is extraordinary.

David Walker points out in an editorial he ran, Mr. Chairman, in the Financial Times that it costs more to buy credit default insurance on U.S. Government debt than on debt issued by McDonalds. It is really scary that the—and he points out, how can one justify bestowing a AAA rating on an entity, the United States, with an accumulated negative net worth of more than $11 trillion and off-balance-sheet obligations of $45 trillion, and an entity that is set to run $1.8 trillion-plus deficits for the current year and trillion-dollar deficits for the years to come?

The chairman has been very generous with his time. But I want to, if I could, Mr. Chairman, just urge OMB to be realistic. And you have kids, I bet.

Mr. ORSZAG. I do. I have two.

Mr. CULBERSON. Let's focus on what is good for them. And forget political party, and let's make sure America is going to be solvent first.

Mr. SERRANO. Thank you so much.

Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

Good afternoon. Well, first of all, let me say how happy I am to meet you. This is my first year on this subcommittee, and I know that OMB faces many challenges. And so I look forward to working with you on many of these challenges.

One I wanted to just reference is the rising unemployment rate, as well as the harsh reality of living in poverty. The national rate now is about 9 percent. In my own State—I come from California—it is a little over 11 percent. Money that was invested in the economic recovery package hopefully will spur the growth of a green energy independent economy and will save countless jobs and create countless more.

But many economists are projecting now that over 10 million more Americans will fall into poverty due to this recession. And so I am wondering if OMB has looked at poverty rates per se and is looking at policies, programs, and initiatives on behalf of the President to kind of make some suggestions on what we need to do to keep families out of poverty and those living in poverty, to help lift them out of poverty. That is the first part of my question.

The second part is, last year, we passed, and it was signed into law, the legislation that repealed the international HIV travel ban. I believe OMB is responsible for reviewing the rule that HHS has put together. I think, if my information is correct, that that was submitted to OMB April 20th of this year.

So I would just like an update on this rule and if there are any specific issues that OMB may have with regard to this, any budget-related issues, and how long do you think this is going to take. Because we passed this last year, it was signed into law by President Bush in our global HIV/AIDS initiative, and it is really time to lift this travel ban and to move on. And so, I am wondering about the bureaucracy in all of this and what your time frame is on it.

Thank you again.

Mr. ORSZAG. Okay, let me deal with the second question first. I need to be careful not to comment on things that are in the middle of the regulatory review process. But I am sure we can get back to you in writing with a date for a timetable for when the next steps will occur.

With regard to unemployment and poverty, I guess I would say several things. First, one of the reasons that the President has put forward, and embodied in the Recovery Act we have, a progressive change in the tax system is, in terms of immediate impact, that, along with strengthened unemployment insurance benefits and other things, provides the most immediate relief to households. So, for example, the Making Work Pay Tax Credit, which is refundable, the American Opportunity Tax Credit for higher education, which also has refundability components, provides relief to low- and moderate-income families.

Beyond that, and as you get out of immediate relief and into the not just providing the fish but learning how to fish, education and health are absolutely essential. And that is one of the reasons why the administration has focused so much on improving our educational system, not only in early childhood but throughout the process, and trying to get more college enrollment and more college graduation through an expanded Pell grant program; through simplifying the application form for Pell grants, which are too complicated right now; through reorienting the Perkins loan program; through a college access and completion fund that we are trying to create.

And, finally, one of the things that I think has not received enough attention—we talk a lot about income inequality in the United States. The growing gap in life expectancy inequality has received very little attention. Most people know that life expectancy is going up. Many people know that better educated, higher-income people live longer than less educated, lower-income people. The fact that that gap between better educated, higher-income people and less educated, lower-income people is literally exploding in life expectancy I don't think has received as much attention.

One of the motivations—it is not the only one, but one of the motivations for reforming the health care system, not only to reduce costs but to expand coverage, is to get at that growing gap.

Ms. LEE. Thank you very much. And let me just add to that, within that growing gap, though, you are looking at a large percentage of that growing gap being with communities of color, in the African American, Latino, and Asian Pacific American communities. Part of the health care reform debate has to include closing those health care disparities.

And I just want to say for the record, Mr. Chairman, the Tri-Caucus, the Black, Hispanic, and Asian Pacific American caucus, have been trying to communicate what you just said to those who are beginning to write this health bill so that we can have a provision in the health care reform bill that really addresses this widening gap in disparities. And a large percentage, as I said, are based on race and ethnicity.

Thank you very much.

Mr. SERRANO. I thank the gentlewoman from California, and I just want to piggyback on that statement.

I think any health care approach that we take has to deal with the disparity. I mean, studies have taken place all over this country, and it just goes right along. It is not just housing, it is not in jobs, it is not how much people make, but it is in the health care delivery and what people get in return within that system.

And so, if we are truly going to deal with health care, we have to make sure that the middle-class gets protected, absolutely, and we have to deal with the disparities in the system.

Mr. ORSZAG. Absolutely.

And, by the way, one other aspect of this is not just health care, but there are other aspects of health behavior that influence that life expectancy gap. For example, one of the things that I think we are hoping for, just as an example, in school nutrition reauthorization is to move the system towards providing healthier meals to kids so that you are on a better path, even apart from the health care system.

Mr. SERRANO. And, with that in mind, a place that produces great food, the gentleman from Florida, Mr. Crenshaw.

Mr. CRENSHAW. You will have a bag of oranges on your doorstep.

Mr. SERRANO. And it is totally allowed under the rules.

Mr. CRENSHAW. Exactly. Thank you, Mr. Chairman.

And thank you for being here today. I just have a couple of policy-type questions to help me understand.

I know you used to work in a different agency, the Congressional Budget Office. And they just, as I understand it, they just came out and said that the red ink is going to be about $9.3 trillion over the next 10 years. And I think the White House, the original number was, I think, maybe about $2 trillion less. So that is about an, I don't know, 18, 20 percent difference in terms of projection, what those numbers are.

I was going to ask you, like, who is right? You are not there anymore, so—but I imagine there are some different criteria or different ways they calculate that. But just help me understand that accounting discrepancy, if you could.

Mr. ORSZAG. Yeah, a lot of it is driven by very small differences in assumptions. One of the things, when you focus on the deficit, the impact gets magnified, because it is a difference between two very large numbers, revenue and outlay. So, for example, if spending is $1,000 and revenue is $950, the deficit is $50. If revenue then falls by 10 percent, the deficit will go up by almost $100, so it will go from $50 to $150. It will triple, the deficit will triple in response to a revenue decline of only 10 percent.

And I think that is often what goes on in differences in out-year numbers, which is, don't make it 10 percent, make it a 1 or 2 percent difference in the revenue number or the outlay number and you get these very dramatically different deficit numbers as a result. Because the deficit is very sensitive to even small changes in assumptions.

And so, CBO itself will say, okay, the 2014 deficit is projected to be X, but our confidence interval is plus or minus $500 billion or $600 billion. So there is a significant amount of uncertainty as you go out over time, and that is because the deficit is so sensitive to small changes in the rate of growth, in capital gains realizations, in the ratio of taxes—lots of variables that feed into it.

Mr. CRENSHAW. But, I guess, is it easy to manipulate what those numbers might be? If they are so sensitive, it is pretty important what the assumptions are, because you can, obviously, make it look better or make it look worse. And everybody is concerned about it. Does that bother you, or is that just kind of part of it?

Mr. ORSZAG. What I think it suggests is being careful about the degree—while you do have to make your best guess, being careful about the degree of reliance that you are placing on, you know, a deficit forecast for 2019, because it is highly uncertain, and the probability that you are right is very, very small.

But, as an example, CBO has a different pattern of economic activity than OMB does. They have, in a sense, slower economic growth for the next year or 2 or 3—I am sorry, faster economic growth, and then slower.

If you look at the out-years, we are at about 2.7 percent in terms of GDP growth. The blue chip is at about the same rate. The Fed is at about the same rate. CBO is below that, and not for any—I don't think they are trying to bias the numbers. I think they just have a different perspective on what the underlying productivity growth rate is, for example. But there is an example where we are in line with blue chip and the Fed and they are below it. And there are going to be others where we are on the other side.

These are done by professional forecasters both at CBO and at OMB. It is unfortunately the case that the art and science of economic forecasting is not as good as we would like.

Mr. CRENSHAW. I got you.

One other question, and this has to do with the big debate when we did the stimulus about Keynesian economic theory. There is a lot of discussion about that. And one of the studies I read, Christina Romer had done a study that kind of indicated, when you are talking about taxes, if you—I think she said tax increases are contractionary and tax decreases are, kind of, expansion-oriented.

When you sit around talking about how to raise revenue, obviously there are some tax increases that are anticipated down the road. One of the things I saw in one of her studies is that if you raise taxes, like, 1 percent of GDP, then it decreases GDP by 3 percent. And, contrarily, if you decrease taxes by 1 percent of GDP, then you raise GDP by 3 percent. Kind of a 3-to-1 ratio.

So, I mean, how does that jibe—when you all are sitting around talking, does she talk about that study that would lead you to believe that, if you reduced taxes, you could actually grow the economy? But there are a lot of proposals to raise taxes that come out of your shop. So, I mean, is she right or wrong, or is that—

Mr. ORSZAG. Let's separate a couple of things.

First, it is traditionally the case that folks will argue, if GDP goes up by $3, you get something like a dollar, or maybe a little bit less than that, but a dollar in extra revenue. That is different from saying that the causality goes in the opposite direction.

Mr. CRENSHAW. But did her study show that if you decreased taxes——

Mr. ORSZAG. I don't think the multiplier was anywhere near that large.

And what I would also say is, in terms of short-term economic impact, she has been very clear, which is consistent with traditional macroeconomic analysis, that if you are if a situation like we have today, where the capacity to produce is much higher than what we are actually producing, and you need to increase aggregate demand, that while tax relief can help—which is one reason why we included that in the Recovery Act—additional spending, that is, investments in infrastructure and direct spending, actually has a bigger per-dollar impact in closing that gap in the short term. And she has been clear about saying that also.

Mr. CRENSHAW. Thank you.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

The gentlewoman from Florida.

Ms. WASSERMAN SCHULTZ. Thank you.

We have Florida bookends for you, Mr. Orszag.

Mr. ORSZAG. There you go.

Ms. WASSERMAN SCHULTZ. Good to see you.

I wanted to turn to the issue of child pornography and the pursuit of individuals who are engaging in child exploitation on the Internet.

I was the sponsor, along with our wonderful Vice President, Joe Biden, when he was in the Senate last year, of the Protect Our Children Act. That legislation was passed into law. It was designed to expand our ability to reach the 500,000—no exaggeration, 500,000—known individuals that are trafficking in child pornography on the Internet. In at least one of three of these pornography trafficking suspects, we have a hands-on abuser who is abusing a real, local child.

So we have been spending, in the previous administration, a colossally irresponsible amount of money. I mean, we were at something like $15.9 million. It was less than 2 percent of the cases—the FBI and the ICAC, our Internet Crimes Against Children task force, was able to investigate less than 2 percent of those cases.

So the Protect Our Children Act authorized up to $60 million a year, for several years, for us to be able to strengthen the ICAC backbone and be able to allow them to investigate more cases. We know that, in 30 percent of the cases, when they investigate them, they rescue a child.

So, at the end of the day, we only had $70 million included in NCMEC's budget this last year, 2009. It went down to $60 million in fiscal year 2010. $21 million of that, in 2009, was budgeted by the Justice Department for the ICAC program. And, obviously, with less money for NCMEC, I assume that there would be less money for the ICAC. I don't have a full breakout on that.

I mean, the resources that we don't spend are the children that we don't save. And what I would like to know is, is the administration committed, through OMB actually including the request in the Protect our Children Act in your budget request next year, as we develop the components of the legislation, to fully funding the Protect Our Children Act and making child exploitation a priority?

I also serve on the Judiciary Committee and had an opportunity to question the Attorney General, who did specifically tell me that he would seek full funding, fight for it, make child exploitation a priority, but also noted that he hoped he had a responsive OMB listening. And I said, "Conveniently, I sit on the Financial Services Appropriations Committee, and I am going to be able to ask him this week."

Mr. ORSZAG. Well, a couple comments.

First, as you noted, there is $60 million in a broader fund, the missing and exploited children programs fund, that can be used for this purpose—part of it can be used for this purpose. In addition, there was $50 million in the Recovery Act that can also——

Ms. WASSERMAN SCHULTZ. But that is the whole NCMEC budget.

Mr. ORSZAG. I understand, but that could be used for this purpose. So, the combined resources need to be sub-allocated, but there are resources there.

I would be happy to work with the Attorney General, as we develop new budget proposals, to ensure adequate funding for this activity. And, you know, I haven't received anything from him. We are in the midst of—we will be, over the next several months, be in the midst of putting together next year's budget. And I would work with you in the appropriations process for fiscal year 2010 to ensure adequate funding.

Ms. WASSERMAN SCHULTZ. That would be great. Thank you very much.

Mr. SERRANO. Thank you.

Mr. Kirk.

Mr. KIRK. Senor estimado.

Mr. SERRANO. Un placer para mi tambien.

Mr. KIRK. We have spent so much time in this hearing talking about your situational awareness on what we have spent and how money is being spent. But a great part of your job is how we raise money. Your second source of funding is borrowed. So I wanted just to see what your situational awareness is, as the director of the Office of Management and Budget, on your current financial situation.

Do you know the answers to these questions: One, how much have we borrowed since you have become OMB director? Two, who is your top provider of funds? Three, have any Treasury auctions gotten into trouble since you took office? Four, have any sovereign governments failed to sell debt since you took office?

Mr. ORSZAG. I am sorry, could you repeat that one?

Mr. KIRK. Have any sovereign borrowers failed to sell debt since you took office?

And lastly, do you know how much the Fed has printed to cover U.S. debt?

Mr. ORSZAG. Okay, so let's just go in order.

I can get you the precise figure, but, given that we are in May, I would be betting that roughly $800 billion to $900 billion in deficit financing and somewhat more than that, given the way that some of the credit transactions are occurring in the Federal budget, have been issued. I can get you the exact number.

Mr. KIRK. Here is why I am worried. Do you know who raises your money on the borrowing side?

Mr. ORSZAG. The Treasury Department does.

Mr. KIRK. Where?

Mr. ORSZAG. Bureau of Public Debt.

Mr. KIRK. Have you ever been to that office?

Mr. ORSZAG. No, I have not been. They report to the Secretary of the Treasury.

Mr. KIRK. Since it is responsible for over 40 percent of the money that you raise, do you think you might want to take a visit there?

Mr. ORSZAG. I would be happy to do so. Again, that bureau reports to the Secretary of the Treasury, and I have full confidence in the internal operations of the Treasury Department.

Mr. KIRK. You may not have that. Actually, you borrowed $3.2 trillion, because, remember, you have to roll over debt.

Mr. ORSZAG. Okay. In terms of net issuance.

Mr. KIRK. Correct. Who is your top lender?

Mr. ORSZAG. The top lender, at this point, would likely be foreign creditors. And within foreign creditors, in terms of cash flow, China probably tops the list.

Mr. KIRK. Has that changed probably in the last 2 months?

Mr. ORSZAG. To my knowledge, I don't know whether that has changed in the last 2 months.

Mr. KIRK. I would hope that you would know the answer to that question, because this is the top provider of external funds to you.

Mr. ORSZAG. Okay, again, though, responsibility within the Federal Government for issuing debt rests with the Treasury Department.

Mr. KIRK. But this is 40 percent of the funds coming into you.

Mr. ORSZAG. I understand that.

Mr. KIRK. Okay. Any problems in selling debt recently?

Mr. ORSZAG. There were rumors of a potential issue with regard to one Treasury auction, but all Treasury auctions have been completed smoothly.

Mr. KIRK. Actually, you had a big problem with a 30-year note. You had to lift the interest rate up 50 basis points. And the interest rate that you assumed for next year, which a lot of you budget projections hinge on, is actually a full half a point below where it is today. So I am worried about your situational awareness.

What about—any other governments, western democracies having trouble borrowing money lately?

Mr. ORSZAG. There have been various concerns in financial markets. I wouldn't want to make a definitive statement without going through the numerous countries that issue debt all the time, especially if you are including just simply rolling over debt as opposed to net issuance.

Mr. KIRK. The U.K. and Germany both failed to auction debt since you have become director. How much money has the Fed printed and then used that printed money to purchase U.S. debt?

Mr. ORSZAG. Expansion of the—I would have to get you the exact numbers, but the expansion of the Federal Reserve's balance sheet has been significant. And I don't have off the top of my head the additional purchases of Treasury securities.

Mr. KIRK. I am worried about that, because this printing of money——

Mr. ORSZAG. I understand the concern.

Mr. KIRK [continuing]. Is $126 billion, so far, of printed money used to cover U.S. debt. If you were a creditor to the United States, would you be worried about that?

Mr. ORSZAG. The particular concern being future inflation?

Mr. KIRK. Correct.

Mr. ORSZAG. No, I—again, look, the Federal Reserve is among the most credible financial institutions—or, central banks in the world.

Mr. KIRK. Let me back up. Has the Fed ever used printed money to purchase U.S. debt at this level, ever, before the Obama administration?

Mr. ORSZAG. My understanding—well, actually, you have to go back to the—in the modern era, after the 1950s, when the Fed and the Treasury went their separate ways, I don't believe that that is the case.

One of the reasons that the Federal Reserve changed policy, however—and I will refer you to Chairman Bernanke—is concerns about whether they were being as effective as they could be in doing their own job. And, beyond that, I am going to defer to Chairman Bernanke, who is, as you know, responsible for the Federal Reserve's portfolio.

Mr. KIRK. Right. Because this authority didn't exist until last year, but now we have basically $126 billion in completely invented cash being used to cover Treasury auctions. It is no wonder that Treasury auctions are succeeding, because you can just print money to cover what you don't sell.

Mr. ORSZAG. There are still significant, as you know, private entities—in fact, frankly, one of the striking aspects——

Mr. KIRK. Let me get to that. When you say significant——

Mr. FATTAH. Excuse me. Could the witness answer the question, please?

Mr. KIRK. All right. Well, I just——

Mr. FATTAH. Chairman, could the witness answer the question?

Mr. KIRK. I actually wasn't——

Mr. FATTAH. We want to be able to hear what he is saying. You asked an important question. I would like to hear him.

Mr. KIRK. You know, I haven't interrupted you.

Mr. SERRANO. Okay, let's have some order in the committee.

Mr. KIRK. Yes, thank you, Mr. Chairman.

I would just say, when you say there has been significant demand, what has happened to the demand for Treasuries since you have been director?

Mr. ORSZAG. Bond yields have increased slightly, which would reflect——

Mr. KIRK. Actually, what I am talking about is the bid——

Mr. SERRANO. But the Chair would note that there is a desire to have the members hear the witness answer the question.

Mr. KIRK. I am actually—let me refine the question. What is your bid-to-sale ratio since you have become——

Mr. ORSZAG. The best indicator of demand for Treasuries is the bond yield. And the bond yield is actually, if anything, remarkably low relative to history. It has increased somewhat. Over the past several weeks, it has increased by, let's say, 30 basis points or so on the long end of the Treasury market. But if you look back over history, both in real and nominal terms, U.S. Treasury debt still has yields that are, if anything, very low by historical standards.

That reflects, again, flight to safety and the view that the U.S. Government is still—that U.S. Treasury securities are still among the safest investments in the world.

Mr. KIRK. So when we see a falling bid-to-sale ratio, which we have seen now, from a 7-to-1 ratio to a 2-to-1 ratio, you would be completely not——

Mr. ORSZAG. No, no, in other words—no, but the yield is a sufficient statistic. So there are various inputs that go into the yield, one of which is the one that you are referring to.

But, ultimately, if you wanted to pick one thing reflecting the confidence or state of demand for Treasury securities, changes in the yield are the best single statistic, in my opinion.

Mr. KIRK. Thank you.

Mr. SERRANO. Time has expired.

With Mr. Edwards's permission, I would like to ask you a question.

Mr. EDWARDS. Any time, Mr. Chairman.

Mr. SERRANO. Thank you.

What was the outlook for the deficit in January 2001, and what was the outlook for the deficit in January 2009?

Mr. ORSZAG. The outlook for the deficit in January 2001 was significant surpluses. The outlook for the deficit in January 2009 was a deficit well in excess of $1 trillion.

Mr. SERRANO. Mr. Edwards?

Mr. EDWARDS. I thank the chairman for getting into my questions.

And, obviously, every member has a right to ask questions. I think Mr. Kirk's questions touch on important issues. I would say, for the record, I am little surprised we are getting into a Jeopardy situation today. And, for the record, let me say, many of the responsibilities addressed by Mr. Kirk's questions are under the jurisdiction of the U.S. Treasury Department and other Federal agencies.

But as long as we are going to play Jeopardy, let me just ask: Is it correct that, prior to the George W. Bush administration, the previous largest annual deficit in American history occurred in 1992, under the administration of former President Bush, President George H.W. Bush?

Mr. ORSZAG. Although, as a share of the economy, there were larger deficits in the early 1980s under the Reagan administration.

Mr. EDWARDS. Right, but in terms of total dollars. Then, so, previously, as a percentage of the total GDP, there were larger deficits during the Reagan administration.

Mr. ORSZAG. Right. And before that, during World War II.

Mr. EDWARDS. And then, in terms of total dollars, the largest deficit was in 1992 of about $292 billion, is that correct?

Mr. ORSZAG. I can get you the exact figure. It will just take me a second.

Mr. EDWARDS. Okay.

Mr. ORSZAG. 1992, total deficit was $290 billion.

Mr. EDWARDS. $290 billion was the largest numerical deficit in any one year in the history of the country?

Mr. ORSZAG. That is correct.

Mr. EDWARDS. And then did President Bush, just to clarify, George W. Bush, when he was sworn into office, did he inherit a deficit or a surplus?

Mr. ORSZAG. He inherited a surplus.

Mr. EDWARDS. Okay. And, at that time, it was projected those surpluses would continue for a number of years, is that correct?

Mr. ORSZAG. That is correct.

Your version of Jeopardy is pretty easy.

Mr. EDWARDS. Yes, I am trying to make it balance out with my colleague. But the points are certainly serious ones.

And am I also correct in understanding that, after the philosophy was pushed—and during the 8 years of the Bush administration, Bush 43, I think 6 of those 8 years Republicans controlled the majority in the House and the Senate. So these were essentially their budget proposals.

We went from $292 billion in 1992 being the largest single deficit in American history to—do I understand the fiscal year 2009 budget, without a dime of deficit being added by President Obama, was going to be over $1 trillion? Is that correct?

Mr. ORSZAG. $1.3 trillion.

Mr. EDWARDS. $1.3 trillion. So that deficit for fiscal year 2009, put in place by former President Bush, again, with 6 of the 8 years of his administration——

Mr. ORSZAG. I am sorry, that was for fiscal year 2010. The fiscal year 2009 was even higher, $1.6 trillion.

Mr. EDWARDS. Okay. But prior to any additional debt being added by the Obama administration?

Mr. ORSZAG. Correct. Well, actually, we would have to take out the Recovery Act. Let's say well in excess of $1 trillion.

Mr. EDWARDS. So about four times larger than any numerical deficit in the history of the country is what the Obama administration faced when he walked into the Oval Office on day one, is that correct?

Mr. ORSZAG. That is correct. He faced a very significant deficit when he walked into office.

Mr. EDWARDS. Now, if I could then go on to the question that I intended to ask.

Although I do want to make a comment. I do want to thank the administration for its record increase request for veterans health care and benefits. It is the largest increase in 30 years, on a percentage basis, ever asked by a President. Just in nominal dollars, it is the largest increase, I believe, ever asked by any President for veterans. And, given the sacrifice made by America's veterans and the continuing sacrifice of our service men and women, I salute the President for his effort in backing our veterans once they come home and face the consequences of their service and love of country.

I just want to quickly ask you about a general sense of what a current services budget would entail. If we assume the same number of FTE, we assume no additional population served, whether it is a veterans program or whether it is a Health and Human Services program, what kind of an increase for fiscal year 2010 do we have to have just to maintain current services? If you make whatever broad and fair assumptions that you have to make. Is it 1 percent, 2 percent, 3 percent?

Mr. ORSZAG. It is several percentage points. And, in particular, are you focused on appropriations in particular?

Mr. EDWARDS. Yes, on appropriations in general.

Mr. ORSZAG. So, in appropriations, it is about $100 billion on a $1.3 trillion base. So let's call it 6 percent or so.

Mr. EDWARDS. So, 6 percent just to maintain present services?

Mr. ORSZAG. Yes.

Mr. EDWARDS. So if one proposed a freeze in a budget—given that there are salary increases, health care cost increases, you are actually cutting present services, is that correct?

Mr. ORSZAG. That would be one interpretation.

Mr. EDWARDS. Okay.

And, finally, I want to thank you for practicing what you preach. You have a difficult job. From most of us, you hear that the deficit is too large but the spending programs that we support are underfunded, and that is a difficult job to take responsibility for.

But you asked for a 5.4 percent increase, and that, according to the number you just gave me, would typically be close to or less than current services. And given all the new responsibilities you have, I respect you for putting limits on your budget request for OMB this year.

Mr. ORSZAG. Thank you.

Mr. EDWARDS. Thank you, Mr. Chairman.

Mr. SERRANO. I thank the gentleman from Texas.

And now the gentleman from California, Mr. Schiff.

Mr. SCHIFF. Thank you, Mr. Chairman.

Mr. Orszag, I wanted to ask you about three issues, and I will just put them on the table as quickly as I can to give you a chance to respond.

The first is the L.A. Courthouse, which I am deeply familiar with. I was an assistant U.S. Attorney in the building for 6 years. It has been the Judiciary's highest priority, in terms of courthouse construction. It is old, it is insecure, it is inadequate in size.

Congress appropriated the funds to build a new courthouse years ago, but many delays have now raised the cost pretty dramatically. And we just need to resolve this. And it will have to be part of an administration budget, because the numbers are just too big to do an add-on. So I would ask you to work with me and try to find a way that we can finally agree on a plan for the courthouse and meet the Judiciary's number-one courthouse construction priority.

The second issue I wanted to raise is NASA. I was delighted to see that we are starting this year with a budget increased to double physical science funding over the next decade. But I am concerned with the budget for NASA after 2010. In fiscal year 2011 and over the 5 years that follow, the NASA budget is essentially flat. With inflation, that means a cut.

As the world leader in science, planetary science, earth science, astrophysics, heliophysics, NASA has some of the foremost experts on climate change. I am deeply concerned about a flat budget for 5 years and how that will affect the agency. So if you could talk a little bit about the administration's plan for NASA's future and whether that is just a temporary placeholder because we have new leadership coming in in NASA or whether there is really an intention to hold the budget flat.

Finally, on SCAAP, this is enormously important for border States like California, and it has been zeroed out by the administration. OMB, a few years ago, made a finding that reimbursements do not reduce the incidence of crime committed by criminal aliens, which I think—it says, the program lacks goals and cannot measure such an outcome.

This is an argument that is really, sort of, beside the point. First, by incarcerating illegal immigrants who have committed crimes, you are reducing crime by incapacitating them. So it is effective. Is it more effective because Federal money is used as opposed to State and local money? If that is the barometer, then there will never be support for the program.

But that wasn't the purpose. The purpose of the program and the language authorizing SCAAP basically said, it is the Federal Government's responsibility to get immigration, illegal immigration, under control. Failing to do that, we need to help to defray some of the costs that are being imposed on the State through no fault of their own.

So that is really the purpose of SCAAP. And you can't measure it by saying, has it changed outcomes? So I would like to get, in your own words, an explanation for why the budget doesn't include funding for SCAAP and whether that is an appropriate barometer of success for the program.

Mr. ORSZAG. So, in reverse order, with regard to SCAAP, two or three things.

First, we do have $27 billion in border enforcement and related activities funding—20,000 Border Patrol agents, 33,000 detention beds. We are trying to take seriously the responsibility of enforcing border security. In addition, we have support for local law enforcement through the COPS program, which was funded in the Recovery Act and in the fiscal year 2010 budget.

With regard to the SCAAP program in particular, the concern has involved the degree to which the funds are actually being used for the intended purpose as opposed to other purposes—purchasing vehicles, other either related or unrelated expenses.

And so the primary concern—or I guess my primary answer is, we want to try to mitigate the problem in the first place, but then, to the extent that there still are unauthorized immigrants who do need to be detained, making sure that programs are as targeted as possible and not used for auxiliary services. That is the main concern.

Mr. SCHIFF. And, Mr. Orszag, we are happy work with you, if there is further language necessary, to make sure the funds are targeted to the costs of incarceration. I am sure the States are happy to do that, because that is where the funds were both intended and my understanding is that is where they are used. But we will follow up with on you that points.

Mr. ORSZAG. With regard to NASA, there is a 5 percent increase for fiscal year 2010.

The out-year numbers will involve an ongoing discussion. As you know, we are transitioning from the space shuttle to other vehicles. There is a gap that arises in the meanwhile. And we have been in active discussions not only with the incoming leadership of NASA but John Holdren, who is the President's science advisor, about the shape of the future NASA activities.

It is one reason why we have asked a panel to take a closer look at how we can get the most from the dollars that we are investing and what the appropriate funding level is. And as that panel reports back, we would hope to work with you to ensure adequate funding for NASA.

Mr. SCHIFF. And on the courthouse?

Mr. ORSZAG. Oh, and on the courthouse, again, we can follow up, and look forward to working with you on that.

Mr. SCHIFF. Great. Because that has been almost two decades in the making, and it just has to be resolved.

And I had wanted to add to my colleagues' acknowledgment of—I am really quite amazed at your encyclopedic knowledge of all the variety of programs you have to deal with. So, thank you for your good work.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Director Orszag, let me ask you a more general question about the role and the proper function of OMB, as you see it.

Most folks, and certainly most people in Congress, understand the core role that you play in putting together the Federal budget. But you also have other roles that you play in reviewing agency policy, regulations, and management.

The question is, does that then create a problem? You are not a very large agency, and if you are going to review a lot, if not most, of what happens in government and people have to wait for you to give them clearance on a lot of these things, aren't you then running the risk of being the bottleneck, the problem in the Federal Government, holding things up?

In addition to that, in the last administration, there was a feeling that, more and more, you were ignoring—not you, but the OMB—was ignoring the desires, the vision, of people who were appointed by the President and cleared in different forms by the Senate, who had to wait for OMB to basically allow them to do what they wanted to do.

How do you see the function of OMB? And do you think that we have to go back to a time when there was less of this desire to concentrate all that power in one office?

Mr. ORSZAG. Thank you for the question. And I do appreciate that there have been concerns raised about the way in which OMB exercised its role in recent history.

Let's take the regulatory process as an example, though. It is clear that the regulatory agencies have responsibility for regulation. What OMB's role is is severalfold. One is to make sure that what this department is doing is not inconsistent with what this department is doing and, sort of, forcing some coordination and collaboration and internal consistency across the various agencies, to the extent possible.

The second is to suggest and to try to preserve some consistency in the methodology. It would be undesirable to have this agency over here conducting a cost-benefit analysis or some other analysis in one particular way and then another agency doing it in a completely inconsistent way.

And then, finally, in addition to upholding the law and the statutes, there is a role for OMB in preserving the role of the President and the President's priorities.

All of which is to say, OMB plays what I would describe as a coordinating and, kind of, internal consistency check role, but the ultimate responsibility for the regulatory process rests with the relevant agencies.

With regard to the size of OMB and whether we are a bottleneck, I have heard such complaints. I heard such complaints about CBO when I was there. What I would urge is that, to the extent that there are concerns, that people get in touch with me. We try to keep things moving and try to be on the ball as much as possible. And if there are particular concerns, I have encouraged other Cabinet officers to let me know or, if you have concerns, to let me know, and we can try to speed things along.

The basic point, though, is there is always this question between the size of an agency and other dimensions. In other words, I would be concerned about OMB getting too big and then losing some of the—if one of the roles you are trying to do is a coordinating and internal consistency check, if you are, yourself, so big that it is difficult to coordinate internally, that is self-defeating.

Mr. SERRANO. You made an interesting point, though. You say that part of the role of OMB is to, sort of—if I heard you correctly—check to make sure that everyone else is carrying out the

President's vision. But, certainly, to me and to most Americans, when the President sits around with his Cabinet, those are all folks that he believes will carry out his mission.

Mr. ORSZAG. I agree.

Mr. SERRANO. So, at what point does OMB—and please understand that these are questions that have been asked for a long time before you were the director.

Mr. ORSZAG. I understand. I am not taking it personally.

Mr. SERRANO. Right. At what point does OMB become a problem for an administration carrying out?

It just seems to us that during the last 8 years, especially, there was a lot of concentration in there. And it is almost like most people were, at times, almost nervous about speaking to appropriators because OMB hadn't cleared it.

Mr. ORSZAG. Well, again, I hope you can understand the underlying rationale, which is—let me speak directly to your point. Even in the first Cabinet meeting, the President was very clear with the various secretaries assembled there that they were appointed not only because they were talented and qualified but also because they seemed to share, in their particular domain, his vision for how to move forward, which is exactly how it should be.

It is also the case that, when you get to specifics, that sometimes questions will arise that the Department of Labor has a particular vision for how to proceed and then the Department of Transportation has a different vision. And that then again raises the question of, how do you make sure that the various agencies are being consistent with one another and what the President is hoping to do?

So I want to again say, primary responsibility—and I should have been even clearer on this—primary responsibility rests with the Cabinet agencies and the other regulatory agencies, and OMB's role is simply to coordinate and make sure that there is a rigorous and consistent methodology.

And then, let's hope this never happens, and I don't think it should, but if there are divergences between what some agency is trying to do that is not required by the law—and let me again make it clear, if something is statutorily required, that obviously dominates all else—but is not required by the law and is inconsistent for whatever reason, through oversight mistake, different interpretation, confusion, what have you, with where the President is, then it is OMB's role to collate comments from other agencies and from White House offices and pass that back or share that information with the relevant regulatory officials.

Mr. SERRANO. Thank you.

Ms. Emerson.

Mrs. EMERSON. I want to come back at the Federal debt issue.

Mr. ORSZAG. Okay.

Mrs. EMERSON. So I am going to start——

Mr. ORSZAG. By the way, we are checking with—because I think there may be some other factual questions.

Mrs. EMERSON. Well, I am starting from fresh.

Mr. ORSZAG. Okay. Although, I do want to again note, I am trying to be cognizant if there are different responsibilities with regard to making sure that we are all executing well on what we have to do. Most of the questions that Mr. Kirk had do rest with the Treasury Department. And just like Tim Geithner has things that he needs to do, I have things on a daily basis that I need to do, and I do rely, I think appropriately, on the Treasury Department to do its job well, which I have full confidence in.

Mr. SERRANO. And Mr. Kirk will have an opportunity tomorrow.

Mrs. EMERSON. Indeed, because we have Secretary Geithner tomorrow.

Mr. ORSZAG. Excellent. You could ask him about, you know, the SCAAP program. I am kidding.

Mrs. EMERSON. I am not getting into all of that.

All right. So the fiscal 2010 budget estimates a current-year deficit of $1.8 trillion and projects deficits to continue through 2019, when the deficit would be about $779 billion.

Your analytical perspectives document states that the Federal debt held by the public will be—I will wait and let you get that.

Mr. ORSZAG. But I am listening.

Mrs. EMERSON. Okay—68.5 percent of GDP in 2014. And, according to the document, this is the highest percentage of Federal debt to GDP since 1950.

So, given the size of the Federal debt, is Treasury crowding out investment in the private sector? In other words, to what extent are investors buying Treasury bonds instead of investing in U.S. businesses?

Mr. ORSZAG. Not very much now. In fact, one of the things that—so the traditional model, if you were in a closed economy and there was no access to international capital markets, a budget deficit would mean crowding out of private investment. But what you instead see is, it has to come from somewhere, and what is occurring—you know, what has occurred over the past decade now is that additional borrowing doesn't seem to be crowding out private domestic investment. Instead, it is showing up in additional borrowing from foreigners.

There still is a cost to doing so. And that is why, although it is important to address the economic downturn, we don't want to be on a path where we are not addressing our medium- and long-term fiscal challenges, because continuing to borrow significant amounts from foreigners does impose a cost on our future.

Mrs. EMERSON. So when you make the decision that the government should borrow more funding for additional spending, how do you balance—and I am not an economist, and you are, that is why I am asking you this question—how do you balance the desire for short-term benefits to the economy versus the long-term risks to future generations of increasing debt?

You know, are we being greedy at the expense of our children and grandchildren, who may end up having to pay? I mean, I am asking that question. I just really want to know.

Mr. ORSZAG. Let me separate that answer into two parts. The first is, what do we need to do to fight off the worst recession since the Great Depression? So, part of that involved the deficits that we were inheriting, but——

Mrs. EMERSON. And believe me, I admit it. You inherited it from my party. I agree.

Mr. ORSZAG [continuing]. But then additional efforts were necessary. The Recovery Act, for example, was intended to get right at the root of that problem by boosting demand again back up towards——

Mr. SERRANO. You know, you spoke over a great statement, but I am not going to ask you to repeat it.

Mr. ORSZAG. I am sorry.

Mr. SERRANO. No, it is okay.

Mrs. EMERSON. I took responsibility.

Mr. ORSZAG. You did.

Mrs. EMERSON. I did.

Mr. ORSZAG. As the economy recovers, the situation changes, and the steps that are necessary to address an economic downturn no longer become necessary. And, at that point, continuing to borrow substantial amounts of money beyond what is sustainable poses risk both to economic performance and to the wellbeing of our children, grandchildren, what have you.

So, from my perspective, the key thing is not what is happening this year but, rather, what happens in 2013, 2014, 2015, 2016, and what have you.

Now, under our budget and under the budget resolution, the deficits come down sharply. And one of the reasons that we are, again, focused on health care reform, coming back to the point earlier, is, if you look out beyond that, it explodes, and we are trying to, you know, I guess I have started to say "bend the curve," bend the curve on health care costs to bring that down. Because, if not, we are on a path that is not affordable.

Mrs. EMERSON. No doubt about it. And so I applaud you for doing that and truly believe that it is imperative that we do health care reform.

When Mr. Kirk asked you about who our largest—who owned, I guess—who held, of foreign countries, the most in Treasury securities and you said it was China, is there a risk of one country owning so much debt? What happens if China stops buying our securities?

Mr. ORSZAG. What I would say is there is a risk from continuing to have to borrow very substantial amounts of money after the economy has recovered. There is no indication that any of our foreign creditors, you know, have a different perspective on that matter than I do, which is to say, right now—let me come back again to the point about yields on Treasury securities.

If there were concerns among creditors about the path that we were on or about changing their mind with regard to purchasing Treasury debt, what you would see is the yield on Treasury securities going up. The yield on Treasury securities will also go up as economic performance improves, which tends to drive up interest rates because the credit markets get tighter.

We have seen some increase in Treasury security yields over the past several weeks, 20, 30 basis points, something like that. So it is something, but it is not the kind of change that you would associate with a dramatic shift in investor sentiment. And I, at this point, don't anticipate any such shift. I think the key thing, again, is, as we recover, we need to bring deficits down.

Mrs. EMERSON. And even though we are going to have a short-term spike in health care costs if we bring in all Americans into some kind of insurance product—let's just call it that—but simultaneously we will reform Medicare, Medicaid, other government types of programs, do you feel that there is a way to design this program so that we will be able to at least have control over the growth, if you will, rather than the uncontrollable 11.1 percent increase every single year in health care?

Because, obviously, Social Security is another issue which is worrisome down the road. But, I mean, I don't know how to—unless you grab hold of everybody in the country and get them into—design some health care system that we can then manage better, I don't know how we otherwise control the growth of health care. Do you?

Mr. ORSZAG. Again, four key steps, in my opinion, are the most auspicious. If you ask—you know, I am a member of the Institute of Medicine. If you go there, that is what folks talk about. I spoke to the Business Roundtable maybe a month or so ago—similar perspectives.

So I guess what I would say is, if other folks have ideas for what will help reduce the growth rate over time, we would welcome them. Because I think we believe we are sort of dialing that up as much as possible in a way that will help restrain the growth rate of health care costs. And if there are other ideas—and I know some of your colleagues are putting forward ideas today, and we welcome that. We want more ideas about what might help.

Mrs. EMERSON. Yeah. I guess I just worry since we are worried about health care costs growing even within the Medicare and Medicaid systems. And if we have a new public plan, if you will, and it doesn't supplant but it, rather, supplements Medicare and Medicaid, I worry that that also might fall victim to the same situations facing Medicare, and Medicaid to a lesser extent.

Mr. ORSZAG. Okay.

Mrs. EMERSON. But, you know, there might be a way to design it otherwise.

Thanks.

Mr. SERRANO. Thank you.

Mr. Edwards.

Mr. EDWARDS. Thank you, Mr. Chairman.

Dr. Orszag, regarding the operations of OMB, itself, it obviously plays a critical check and balance, balancing and checking Congress and the various Federal agencies, as you mentioned.

Does OMB have its own inspector general?

Mr. ORSZAG. No.

Mr. EDWARDS. It does not.

Mr. ORSZAG. No.

Mr. EDWARDS. Is there a reason for that?

Mr. ORSZAG. Well, I mean, inspector generals are usually looking, again, at internal operations. And we are, at least on the scale of a Cabinet agency, an extraordinarily small, 500-person entity.

Mr. EDWARDS. All right. Who, then—I think that the brilliance of our Founding Fathers was to set up a system of checks and balances within our government. There should be. The House can check the Senate; the Senate can check the House. We can check the White House. The White House can veto a bill. We can override a veto.

Let's just assume—I believe the general perception is that OMB runs its business professionally. That is probably reflected in the high job approval ratings of those who work there. But assuming there were a problem at OMB, if we don't have an inspector general at OMB, who is to be the check and balance on OMB to see that it is doing its job well?

Mr. ORSZAG. Well, there are several—I mean, first, we have several statutory, Senate-confirmed officials. So one check is obviously the legislative branch, because we can be called to testify.

In addition, we are very integrated into the White House. And, to the extent—it depends, I guess, on exactly what the nature of the concern would be. Inspector generals are often looking for either fraudulent behavior or lack of application of guidelines and what have you—much more appropriate to agencies that are administrating large programs. We are not operational, and inspector generals are typically focused on operational issues.

Mr. EDWARDS. But yet you are influencing multibillion-dollar decisions, what goes into the President's budget. When a four-star general or a secretary of a military service testifies before the subcommittee I chair, Military Construction and Veterans Affairs, I believe OMB has to approve their testimony.

If undue political considerations were influencing decisions, if that happens on earmarks, even though "earmark" has become a four-letter word now, the public and press have access to that. It is a very transparent process. The OMB process, for many of us, including those of us in Congress, is a black box, and we are not sure how decisions are made within the OMB, and I doubt the public and the press really know.

I am not suggesting there is anything going on at OMB that deserves an inspector general review. But I think, in general, the principle our Founding Fathers of checks and balances within our system has served our Nation well. And given the incredible power of OMB, both on the regulatory side—let's just say, for example, OMB—OMB, just for the record, has considerable input on regulatory processes, right?

Mr. ORSZAG. In a coordinating kind of way, yes, as I mentioned before.

Mr. EDWARDS. Okay. So, if in——

Mr. ORSZAG. But let me even note there, I mean, for example, the office responsible for that process, OIRA, has a Senate-confirmed official at the head of it. We are actually awaiting Senate confirmation for the President's nominee for that office. That official can, therefore, be called to testify and, you know, frequently would be if there are concerns. I also want to——

Mr. EDWARDS. But the question is, how would you find out—if we had concerns we were aware of, yes, we would call that person to testify. But——

Mr. ORSZAG. That is a great example where almost everything is in the public domain. In fact, last week, there was a question—OMB tends to take comments that come in and collate them and send them back to the relevant agency. That is in the public domain. And there were media reports attributing to OMB comments that came from one of the agencies where we just simply collect the comments and pass them back. That is in the public domain.

But I think, more broadly, I am very committed to transparency, in a variety of dimensions. I mean, I don't want to make it too trivial, but I started a blog at OMB, in part because I thought we could better explain what we were doing, and have gotten a good response to that.

In the regulatory sphere, there are legal requirements, in terms of disclosure. And I am hoping that we can not only meet those statutory requirements, obviously, but go beyond that to the extent that it is feasible.

So I think, in most areas, you will see transparency with regard to OMB's operations. And, beyond that, again, we can be called to testify, which is a helpful discipline. And, beyond that, we also have a White House operation that is clearly very attentive, which is to say, if there were a concern about OMB's operations that an agency had, not only have you heard about some of those concerns, which I think is as it should be, but, frankly, the President and the White House would hear about them also. And that is a—I think we all need to be clear about—you know, that provides a discipline to OMB's own operations, which I think is healthy.

Mr. EDWARDS. Well, my time is up. I will finish by saying I think it is a great compliment to the professionalism of the OMB staff, the professional staff that work there year-in, year-out, decade-in, decade-out, that it hasn't had its own inspector general and yet there have not been the kind of scandals that we have seen throughout other Federal agencies.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

You know, even health care—the health care issue is obviously a very serious issue, but even during discussion of very serious issues you can have a chuckle. And I remember during the campaign, every time candidate Obama would say, "We have to give the American people the same health care plan the Members of Congress have," I couldn't help but think, "I wonder if Senator Obama knows that we don't have vision or dental, that we have to add that on." And so, we hope that you give the American people the full plan, not the one we have.

Although I am not complaining about anything that I have as a Member of Congress, for the record, especially the opportunity to meet folks like you who come and testify and instruct us as much. And I read that exactly the way Mr. Edwards wrote it for me.

Let me ask you—I have just one more question to ask you, and that is, during the previous administration, OMB pressured Federal managers to do more and more contracting out of functions being performed by Federal employees. Some of these contracts may have made sense and increased efficiency. In many cases, though, the main effect seems to have been a lot of money and effort wasted on doing studies, demoralization of the workforce, and disruption of agency services.

Our subcommittee included language in 2009 government-wide appropriations provisions placing a moratorium on further outsourcing studies. And I am pleased to see that you propose to continue that moratorium. This is only a temporary step, though, pending a comprehensive review of contracting-out practices and implementation of new policies that can separate sound practices from others.

Some have suggested that the government really doesn't know how many contract employees it has working for it, knowledge that would seem an important first step in getting a handle on this problem. Therefore, in the 2009 appropriations bill, we asked for a report on the size of the workforce as of the end of 2008, by agency and by number of civilian, military, and contract employees.

Can you tell us how that study is coming? Can we expect to receive it on schedule this September?

Mr. ORSZAG. Two things. One, we have been developing appropriate methodologies for reporting back by September. I think progress is good. In addition to that, we are looking into—there is a separate requirement, and we are looking into conducting pilot projects with particular agencies to get a more nuanced and accurate count of contractors.

One of the frustrations, as you may know, the Army took 5 years or so to do a full enumeration of the number of contractors. That takes longer than would be useful, and so we are looking at ways of piloting with different agencies, a way of getting a timely and accurate count.

For the September report, we are going to have to rely on approximations and methodologies that are not a direct enumeration but rather a statistical guess at what the number of contractors are.

Mr. SERRANO. We also included language in the 2009 bill encouraging studies of where it might make sense to do some insourcing—that is, replacing contractors with Federal employees. Can you tell us what OMB is doing to encourage agencies to implement that policy?

Mr. ORSZAG. Well, I think you have seen a significant announcement, for example, by Secretary Gates, suggesting that much of the activity, including in the acquisition field, that had been contracted out will be brought in-house. And that is exactly as I think it should be.

So across the government, as you know, the President issued a memorandum in early March on this topic. We are cognizant of the concerns about the line between Federal activity and contracting out having gotten blurred, if you will, over the past several years and the need for better clarity about what is inherently governmental and should be done by Federal employees.

Mr. SERRANO. Right.

And the last part is, I am sure you are aware of this whole understanding by some people that you have people that are being contracted making policy decisions that really should be made by civil servants. What can you tell us about that? What concern is there that this is getting a little out of hand?

Mr. ORSZAG. Well, again, the concern is that the line has become too blurred, and things that are inherently governmental, including making policy decisions, belong to be made by Federal employees. And we are aware of the concern. We are working to implement a set of changes.

I will, again, point to the Defense Department as being one of the key actors in which that line is being redrawn. But beyond that, we will be redrawing the line and providing more clarity that Federal employees need to be conducting inherently governmental activities.

Mr. SERRANO. One last point. Let's say that, of the three people that are sitting in that front row, two are Federal contractors and one is a civil servant. Are they then—and a lot of people are not clear on this—are they then covered by the same ethics rules of that agency and everything? Or is one person covered by whatever?

Mr. ORSZAG. Not always. And one of the reasons in getting——

Mr. SERRANO. The answer was no?

Mr. ORSZAG. One of the reasons in even the difficulty of counting is, you know, you sign a contract for something, and that entity then has a bunch of people working on it. They often will not be necessarily reporting the number of employees directly. And one of the reasons the Army found such difficulty in obtaining the number of contractors is that reaching down to getting all the people who are working on a contract is not necessarily the easiest thing in the world.

So there are a variety of concerns involved in the contracting out that has occurred, and we need to be much more disciplined about it.

If I could also, by the way, just because I can't help attention to detail, just for the record: As of the end of March, which is—I don't know why I am obsessed with this, but I will nonetheless report back to the committee—as of the end of March, which is the latest data that we have, China remained the largest holder of Federal debt, with $768 billion in Federal securities; Japan was the second largest.

The flow since Inauguration has flipped slightly, with China purchasing roughly $60 billion in debt and China $40 billion. But nonetheless, China remains the largest foreign holder of U.S. securities.

Mrs. EMERSON. Can you repeat that? It flips, so is Japan is number one and China number two?

Mr. ORSZAG. No, no. So the one question is——

Mrs. EMERSON. Well, you said China and China in the last one. I got confused.

Mr. ORSZAG. Oh, I am sorry. China remains the largest holder of Federal securities. Japan is second. But if you look at new purchases, there has been a slight change since Inauguration, with Japan purchasing $60 billion and China purchasing $40 billion.

Mrs. EMERSON. Yeah, that is what I thought you meant. Okay. I just wanted to clarify that.

I have three questions, and they are little questions.

One of the things that you all have done tremendously well, I think, is to try to call on each of the departments of the government to be more efficient. And one example would be the Department of Homeland Security, with regard to its office supplies, saving $52 million, which is quite shocking. I am sure you were as shocked as I was about that.

Are you working with all of the other departments to do the same?

Mr. ORSZAG. Yes. And, as you know, the President has asked the Cabinet to report back on at least $100 million in savings. I am hoping we will exceed that threshold. The Cabinet officers are currently conducting—they are, sort of, looking through and seeing what they can save. This is not in terms of policy proposals, nonlegislative, just in terms of internal administrative functions where they can save money.

Mrs. EMERSON. Well, let me say, because I know that DHS saved $52 million by not going through the GSA, but, just for fun, we took three items that are on the GSA schedule. One was one pack of pens, and another was a pack of something else, and another thing was a stapler, just a regular old stapler, an old-fashioned stapler that we have on our desks.

The stapler at Staples or Office Depot, one of the two let's just say, was $6.74. And the same stapler with the exact same VIN number on the GSA acquisition was $10 and some cents. Now, keep in mind the millions of staplers we buy. All right, that just annoyed me. Plus, it took 17 days for the stapler to get from the GSA place to your agency, OMB, and it took 3 days from Staples.

The pens, a little bit of—not so bad. Maybe one was 60 cents more a box and the other was 50 cents more a box.

But when you consider the magnitude of a number of these items that every single department has, I mean, you—I guess my point is, I would like to you take a look at the GSA acquisition table and really see if they are getting bargains. I mean, heaven knows you would need a trillion interns, practically, to go through everything and make comparisons, but we just did three and it was shocking that there would be a $4 difference in the same exact stapler.

So, anyway, I really am pleased that you are doing that.

Another thing that is kind of a pet peeve of mine, and it has to do—and you brought up the child nutrition bill. And the child nutrition bill is not at all a pet peeve of mine; it is the process. In other words, here we are, we have the Labor and Education Committee handling child nutrition, but yet, really, child nutrition per se is an agriculture function. And I realize that both agencies work together, but are you also looking at—you know, you say, well, it is important that we are forcing collaboration among the agencies where they have, perhaps, a joint jurisdiction.

Are you looking at anything to try to consolidate some of these functions? Like, food safety, I guess, would even be a better one.

Mr. ORSZAG. Food safety is a classic example.

Mrs. EMERSON. Classic example. I mean, somebody, one or the other, ought to have it. But to have two sets of policies, one for poultry and meat, one for dairy, I mean, it is just craziness. And it ought to be done—and I hope that is part of the process, too.

Mr. ORSZAG. I believe that both Secretary Vilsack and our FDA commissioner, Peggy Hamburg, who were just confirmed last night, if I remember correctly, are both interested in finding more efficient ways to consolidate the food safety regime in the United States. Because it is clear that the current system has flaws that the National Academies and others have pointed out and inconsistencies that don't make sense.

Mrs. EMERSON. And I dare say—and this probably will ruffle some feathers, but I am going to say it anyway—there are committee chairpeople who wish not to lose jurisdiction over things that I know kind of hurts the process of trying to become more efficient. But it seems to me, particularly on the food safety issue, that is one place.

And even on child nutrition—I mean, my Ag Subcommittee on Approps ought to be dealing with child nutrition as much, quite frankly, as Education and Labor, but we don't deal with it at all. To me, it seems crazy. So, anyway, hopefully you will look at those kinds of things, too.

And my last question, Mr. Chairman, has to do with the Recovery Act. And you have stated—and I don't remember when, maybe it was even today—that the government right now is spending about a billion dollars a day in stimulus funding.

So if you all are able, at OMB, to account for the expenditure of the stimulus funds for internal purposes, when is it going to be possible for the consumer, our constituents, to get that same information all the way down to the contractor level? In other words, we know that Missouri got X amount of money, and we know X amount of that went to the transportation department and perhaps X went to somewhere else. But, beyond that, nobody knows anything.

And I know that Earl Devaney has also said that he is worried about—you have the money to let us know all that information, but he is worried about, you know, your time frame. Is there anything else that we can do to help you so that you can speed the process up, or is it just a physical impossibility?

Mr. ORSZAG. Two comments. One is, as you know, responsibility for recovery.gov, which would be the portal or the Web site through which that information is provided, does rest now with Earl Devaney and the oversight board.

In addition, one of the challenges is the underlying financial plumbing or financial architecture of the Federal Government does unfortunately involve some delays in aggregating information. It has been a frustration with USAspending.gov and with other related activities.

We are working to accelerate the timelines as much as possible, but it is true that there are still lags involved in the process that seem surprising to outsiders.

Mrs. EMERSON. But is there anything that we can do to help you? I mean, I realize that there is some inherent lag that is always just going to happen, but——

Mr. ORSZAG. Yeah, I appreciate the concern. I could perhaps come back to with you specific suggestions. But my understanding and my impression is that we are being as aggressive as we can, and I don't know that there are any additional things that you can do for us right now that would help speed it even further. But I will come back to you even in writing.

Mrs. EMERSON. I would appreciate that. Just let us know, okay?

Mr. ORSZAG. Sure. I appreciate that.

Mrs. EMERSON. Thanks.

Mr. SERRANO. Well, we only have one last question, but just an observation, listening to you go back a couple of times to the China issue.

You are not going to find a Chair and a ranking member who agree on an issue as much as Jo Ann and I agree on the fact that we should have a better relationship with the Government of Cuba. And yet we hear all of this talk about China. And it begs the question, so how is Cuba a threat to us? But that is not for you to answer.

Mr. Edwards.

Mr. EDWARDS. Dr. Orszag, if you could give a quick answer, maybe I could stretch this into two quick questions——

Mr. ORSZAG. All right.

Mr. EDWARDS [continuing]. Maybe the first one being quickest.

Congressional earmarks as a percentage of the total Federal budget, including discretionary and mandatory spending, give me a ballpark.

Mr. ORSZAG. Way under 1 percent.

Mr. EDWARDS. Way under 1 percent. Okay.

And since that was so quick, if I could stretch the chairman's goodwill, one last question.

This discussion—it came up earlier in this hearing today—the sense that you can cut taxes by $1 and that will generate $1.05, $1.10, or $1.20 in extra Federal revenue. If that were the case, this would be an easy problem to solve. Let's cut all the marginal tax rates to 1 percent, and we will have almost an infinite amount of Federal revenue. So it doesn't even pass the commonsense test.

But as a Budget Committee member, back when you were wearing the nonpartisan hat as director of CBO, you did a study on the impact of tax cuts and dynamic scoring. As I recall—if you could just quickly tell us some of the results of that.

As I recall, it said that, on average, many economists, most economists would say, if you cut taxes by a dollar, maybe at most it might raise 20, 22, 23 cents back, so you have a net loss of revenue to the Federal Government of 75 to 80 cents. But then if you are actually paying for tax cuts by borrowing money, which is what we have done over most of the last 8 years, it actually could reduce economic growth.

Mr. ORSZAG. That is correct.

Mr. EDWARDS. Could you summarize? Address the issue, does a dollar in tax cuts pay for itself?

Mr. ORSZAG. No. There is no credible evidence that tax cuts pay for themselves.

You correctly summarized the CBO study, which I think reflects the consensus in the economics community, which is that deficit-financed tax cuts, not only do they not cause a boom in economic activity over the medium or long term, the net effect may well be a negative. And that is because any benefit you get from lower marginal tax rates or better incentives to work and to save can be offset by the drag from a larger deficit.

Mr. EDWARDS. Okay.

Thank you, Mr. Chairman.

Thank you very much.

Mr. SERRANO. Thank you.

And we thank you, Director Orszag, for your testimony today, for being with us. We stand ready to assist you, to be your partner.

If this chairman has a concern, I have already voiced it, and that is that there is plenty for OMB to do and OMB will always be an important agency, but the last 8 years allowed OMB to take on a role that we think does not go with the job description, if you will.

Nevertheless, we are here to be supportive and to help our country move forward. And we thank you.

Mr. ORSZAG. I appreciate it. Thank you.

Mr. SERRANO. The meeting is adjourned.

Testimony of Peter R. Orszag,
Director of the Office of Management and Budget
Before the Subcommittee on Financial Services, Committee on Appropriations
U.S. House of Representatives
May 20, 2009

Chairman Serrano, Ranking Member Emerson, and Members of the Subcommittee, thank you for giving me the opportunity to discuss the President's Fiscal Year 2010 Budget request for the Office of Management and Budget.

In the face of the worst economic crisis since World War II, the President's 2010 Budget seeks to help lift our economy out of recession, while also laying a new foundation for long-term growth and prosperity.

In laying this new foundation, the Budget focuses on four key priorities:

- **Health care reform.** The Administration is committed to working with Congress to complete health care reform this year that decreases costs, increases quality, and expands coverage. One of the biggest drains on American pocketbooks is the high cost of health care. Health insurance costs reduce workers' take-home pay to a degree that is both underappreciated and unnecessarily large. At the same time, health-care costs are the key to the Federal Government's fiscal future. If costs per enrollee in Medicare and Medicaid grow at the same rate over the next four decades as they have over the past four, those two programs will increase from 5 percent of GDP today to 20 percent by 2050.

  Already, the Administration has taken important steps to improve the efficiency of our health-care sector. In February, Congress passed and the President signed the American Recovery and Reinvestment Act (Recovery Act), which is providing resources for electronic medical records, patient-centered health research, and prevention and wellness interventions so that we have the infrastructure in place to lower health spending while enhancing health outcomes. The President's Budget also proposes a historic $635 billion health care reserve fund as a down payment towards fundamental health reform. The reserve fund includes a set of quality-enhancing changes in incentives for Medicare and Medicaid, such as paying hospitals with high rates of readmission less if patients are re-admitted to the hospital within 30-days after discharge.

  The Administration is now working closely with Congress to build from this foundation and to develop a comprehensive plan to reform the health care system in a way that is deficit neutral over the next five to ten years and that puts in place the structural changes needed to improve health-care quality while reducing long-term costs.

- **Education.** Promoting long-term economic growth requires making long-overdue investments and reforms in education. The President's Budget does so by investing in programs that work, cutting those that don't, and expanding educational opportunities—from early childhood through college. For example, the Budget proposes $800 million in new investments targeted to high-quality early learning. Rigorous research shows that the strongest early learning programs pay off in higher productivity and lower crime decades hence. Because effective teachers are the most important element of effective schools, the Budget invests an additional $420 million in new approaches to recruiting, retaining, and rewarding successful teachers in the schools and subjects where we need them the most. The Budget would also launch a planning effort to establish new Promise Neighborhoods modeled on the extraordinary success of the Harlem Children's Zone in improving achievement for poor New York City children. And because every child deserves access to an affordable college education, the Budget proposes to increase the maximum Pell award to $5,550 in the 2010-2011 school year and index the grant afterward so that it better keeps up with the rising cost of tuition. We would pay for this expansion by eliminating subsidies to banks in the wasteful Federal Family Education Loan program and making loans directly to students instead.

- **Clean energy.** The Administration is pursuing a comprehensive plan to invest in clean energy, reduce our dependence on foreign oil, and address global climate change. This starts by improving energy efficiency, which can be one of the cheapest, cleanest means of reducing greenhouse gas emissions. For this purpose, the Budget includes a $779 million investment to fund an expanded building technology program, vehicle technologies, and smart grid technologies (a 40 percent increase over 2009 for the sum of these programs). The Budget also supports efforts to make America the world leader in the new clean energy economy. To this end, the Budget includes $445 million to power the development of solar, wind, and geothermal energy (a 60 percent increase over 2009 for the sum of these programs). The President's Budget also supports a market-friendly cap-and-trade system to reduce carbon emissions, after the economy recovers, beginning in 2012. The expectation that this policy will discourage carbon use in the future should spur a range of clean energy investments and jobs today. In addition, the President announced just yesterday a national policy to increase fuel economy and reduce greenhouse gas emissions for cars and light trucks manufactured in 2012-2016. This new policy calls for national standards that are as stringent as those proposed in California (and the 13 states and District of Columbia that intend to follow the California standard).

- **Fiscal discipline.** Upon taking office, the Administration inherited trillions of dollars in deficits. The Budget would cut the deficit in half by the end of the President's first term. In addition, the Administration is committed to achieving comprehensive health care reform this year. This will lay the foundation for reducing the long-run growth of health care costs and is the single most important step we can take to restore long-term fiscal balance to the Federal Government.

This is an ambitious agenda that is designed to meet the challenges of our times, and bringing it to fruition will require making Government work better—a mission at the core of OMB's activities.

Making Government Work Better

OMB plays a pivotal role in developing and supporting the President's management, budget, and legislative agenda. OMB assists the President in the preparation of the Federal budget and in managing its execution throughout the departments and agencies. In helping formulate the President's spending plans, OMB examines the effectiveness of agency programs, policies, and procedures; assesses competing funding demands among agencies; recommends funding priorities; and provides policy options.

President Obama is committed to improving the performance of the Federal Government and also to operating with a historic level of transparency and citizen engagement. OMB helps to advance this agenda through several efforts.

Evidence-based policy

The President has made clear that policy decisions should be driven by evidence. OMB is committed to evidence-based policy as the primary driver in both our budgetary and regulatory processes. The President's Budget this year included a separate volume of terminations, reductions, and savings in which we outlined how we propose to trim $17 billion from Federal programs that have been determined to be ineffective, duplicative, or obsolete. In turn, we proposed targeted funding for programs that have demonstrated measurable results, incorporate data collection and evaluation, and utilize cost-benefit analysis and other methods to demonstrate results. The non-partisan Coalition for Evidence-Based Policy has commended the Administration's expansion of funding for proven evidence-based policy initiatives.

Transparency

Transparency promotes accountability and provides information for citizens about what their Government is doing. Moreover, technology increasingly allows the Federal Government to provide citizens with improved access to information about the use of their tax dollars and with the opportunity to give feedback. The Administration will continue to innovate in providing mechanisms for transparency and openness, and in devising new tools to let citizens have their voices heard by those who serve them. For example, the Administration is dedicated to making more Federal data available to the public in more usable forms. To further this priority, several initiatives have been and will be undertaken:

- ***Recovery.gov***. The Recovery Act is an extraordinary effort to jumpstart our economy, create and save millions of jobs, and put a down payment on addressing long-neglected challenges so the country can thrive. To give the public a thorough understanding of how and where Recovery Act funds are invested, the Act itself provides for unprecedented levels of transparency and accountability so that citizens will be able to know how, when, and where their tax dollars are being spent. Recovery.gov, a website maintained by the Recovery Accountability and Transparency Board, allows the public to monitor the progress of the Recovery Act, to track contracts and Federal grants to an unprecedented degree, and to provide feedback on the status and results of those investments at the community level. This information source will continue to be improved as more data become available.

- ***USASpending.gov***. USASpending.gov is designed to provide a searchable database of Government awards and contracts, including information detailing how, when, with whom, and on what the Government is spending taxpayer funds. Visitors to the site may download data and related information from USASpending.gov to combine into customized data sets for research and analysis. Planned enhancements to USASpending.gov include integration with performance data, budget and financial data, and more detailed investment data.

- ***Data.gov***. The Federal CIO Council is launching Data.gov, an online repository for access to non-restricted Government data. Through information presented in downloadable formats on topics such as the environment, energy, health care, and the operations of Government, Data.gov has the potential to drive innovation in the public and private sector. Just as Internet mapping industries developed from the release of public geographic locational information, data transparency can spur economic, scientific, and educational innovation.

Management agenda

Achieving real and lasting change will require a focus on targeted, high-priority issues combined with Government-wide performance improvements. OMB will be asking each major agency to identify a limited set of high-priority goals and will itself set priorities for cross-cutting management initiatives, such as reducing improper payments, disposing of unneeded real property, reforming the contracting system, and creating a set of Government-wide metrics that will be used to prioritize reform priorities and hold managers accountable for achieving their goals.

OMB will not and cannot complete this work alone. OMB has approximately 50 staff dedicated to Government-wide management, but it is not involved in the day-to-day management of Federal agencies or setting management policies for specific agencies or programs. What OMB will do is collaborate with Federal agencies to improve management, foster partnerships, and drive organizational change via its leadership of the President's Management Council and other interagency councils focused on management reforms. OMB will also work closely with Congress, GAO, and other stakeholders to lay out a regular process for engaging Congress on high-risk or timely agency- or program-specific performance issues.

The framework developed through this collaborative process will further the President's priorities and address longstanding performance and management challenges. The goals OMB will work to achieve include the following:

- *Putting Performance First*. The President has nominated Jeffrey Zients to serve as the Nation's first Chief Performance Officer and OMB's Deputy Director for Management. If confirmed, he will lead the Administration's efforts to build a Government that performs better, costs less, and provides a historic level of transparency to both Congress and the public. We are committed to working alongside agency performance offices and to using performance and evaluation information to guide management decisions at all levels of Government.

- *Transforming the Federal Workforce*. Government performance depends heavily on the quality of its workforce. Almost half the Federal workforce is projected to retire during the coming decade. This retirement wave presents a challenge because the Government will be losing top talent, expertise, and institutional memory. At the same time, there is an opportunity to reform and reenergize the Federal workforce by improving how the Government hires, trains, and evaluates individual performance.

- *Reform Federal Contracting and Acquisition*. The Administration's efforts to reform how the Government does business will include strengthening our contracting practices and making sure they are aligned to support program outcomes. Already, the Administration has announced procurement reform that will greatly reduce no-bid contracts and save the Government up to $40 billion, and Secretary Gates recently announced a courageous set of reforms to reduce hundreds of billions of dollars in waste and cost overruns in defense acquisitions. In the coming months, OMB will issue guidance and promote new practices to (1) strengthen acquisition management, (2) maximize the use of competition, (3) improve how an agency decides what type of contract can best meet its needs, (4) strengthen the acquisition workforce, and (5) clarify when Government outsourcing is appropriate and when it is not appropriate.

- *Program Integrity*. Too often, weaknesses in agency internal controls and program oversight lead not only to inefficiencies in Government operations, but also to avoidable financial errors that compromise citizens' trust in government. OMB will work with Federal agencies to initiate new financial management disciplines that drive efficiencies in operations and improve our track record in preventing significant instances of fraud and error before they occur. In particular, the President's Budget has proposed to establish a $175 million Partnership Fund for Program Integrity Innovation, which would invest in new efforts to reduce error and improper payments in Federal means-tested programs administered by States, such as Medicaid and the Supplemental Nutrition Assistance Program (formerly Food Stamps). OMB will oversee the development of rigorous methodologies for measuring the potential savings from these investments, including both administrative efficiency gains and reductions in erroneous payments. No projects would be funded unless they demonstrate their potential to result in more than one dollar in administrative and program savings for each dollar invested.

OMB Staffing Levels

OMB could not succeed in its efforts to maintain fiscal discipline and make Government work better without its small cadre of extraordinarily dedicated and highly qualified staff. In recent decades, as OMB has taken on significantly expanded responsibilities—such as for financial management, procurement oversight, and e-government, to name a few—the staffing levels have steadily declined.

By FY 2008, staffing levels at OMB had fallen to 474 full time equivalents (FTEs). Except for FY 2006, this was the lowest level of employment at OMB since comparable data became available starting in around 1980. This represents a drop of more than one-quarter since employment levels at OMB peaked in the early 1980s and a fall of 8 percent since FY 2000.

In its FY 2009 appropriations, Congress recognized that staffing at OMB had become insufficient to meet OMB's considerable core responsibilities. For the current fiscal year, Congress provided funding to increase the number of FTEs at OMB to 528—the level at which the Administration proposes to maintain OMB staffing for FY 2010. I thank the Subcommittee for having funded this additional staffing and believe it represents an important investment in planning and oversight that will yield considerable returns in the future.

FY 2010 Budget Request

For FY 2010, the President's Budget requests $92.7 million for OMB, which, as noted, would support an FTE level of 528—the same as this year's FTE level.

This requested level represents an increase of $4.7 million, or 5.4 percent, relative to the FY 2009 funding level. Sixty percent of this increase (or $2.9 million) is attributable to annualizing the cost of the new FTEs provided for in last year's appropriations bill, which covered half the fiscal year.

Beyond this, we are also requesting an increase of $1.8 million, or about 2 percent. $1.6 million of this increase represents pay and benefit adjustments for staff to, for instance, pay for the rising cost of health benefits. The remainder covers inflationary adjustments for materials and other overhead, annualizing the cost of additional Blackberry service started this year, and MAX budget system operation and maintenance costs. This also reflects a reduction of $355,000 for office furniture and equipment.

I believe that with the level of resources requested in the Budget, OMB will be able to efficiently fulfill its considerable responsibilities to serve the President and meet its duties to Congress and the American people to maintain fiscal discipline and make Government work better for all Americans. I look forward to working with the members of this Subcommittee, and I would be happy to address any questions the Subcommittee may have on the OMB budget or other issues.

THURSDAY, MAY 21, 2009.

TREASURY DEPARTMENT

WITNESS

HON. TIMOTHY GEITHNER, SECRETARY

Mr. SERRANO. Today the subcommittee meets to discuss the work of the Treasury Department and its budget request for fiscal year 2010. I am pleased that the request includes funding for expanded IRS enforcement efforts targeted at individuals and businesses seeking to park cash overseas in order to escape U.S. taxes. I am also pleased to see the strong funding increase for the Community Development Financial Institutions Fund to provide capital and financial services for underserved low-income communities throughout the country, communities that are suffering most from the current state of the economy.

At the same time, however, I am dismayed that the Department is refusing to abide by a key provision of the fiscal year 2009 Appropriations Act relating to agricultural and medical sales to Cuba. This is totally unacceptable, and I will have more to say about this today. Of the Treasury Department's many responsibilities, none has attracted the attention and concern of the American public as much as the Department's role in responding to the financial crisis, and in particular, the Department's implementation of the Emergency Economic Stabilization Act of 2008. Its success or failure is just too important to the country and to all our constituents.

There are several key questions we must ask. First, are the Department actions helping to restore confidence in the financial markets? Are credit markets opening up again? And is lending increasing again? Second, are the Department's actions helping to stem the tide of home foreclosures in this country? Last month alone, more than 340,000 properties received a default or auction notice or were seized. As highlighted by a study released last week by the Pew Research Center, 85 percent of the neighborhoods worst hit by foreclosures are minority neighborhoods. Other research has found that tenants make up a large percentage of those who lose their homes in foreclosure because their new landlords do not have to respect the leases signed by the old landlord.

While I am encouraged that the Department has unveiled a plan to prevent foreclosures, and while it is reasonable to expect that the plan will take some time to see results, this problem is of utmost urgency to millions of Americans. A third question is whether the American taxpayer is getting a good deal. Will the taxpayer recoup the massive public investments that are being made in financial institutions? I have said in the past that when Wall Street was doing great and these guys were giving each other $50 million bonuses, I could not see anything happen to my district in the Bronx that made me say, 'wow, there is some good from what is happening on Wall Street.'

Now Wall Street is not doing as well, bonuses have still been paid, and many of the problems in my district, especially the foreclosure problem, are getting worse. I hope that the Department will keep in mind the needs of all Americans and all communities, and not just Wall Street, as we attempt to solve the crisis.

I expect that we will have a very healthy and vigorous discussion this morning. Secretary Geithner knows more about these issues than most anyone else in the country, having previously headed up the Federal Reserve Bank of New York.

Secretary Geithner has also played a lead role in the Treasury Department's responses to the global financial crises of the late 1990s. We welcome you today, Mr. Secretary, and look forward to your testimony today. You were supposed to be our first hearing. As it turns out you are our last hearing. But somehow you were either going to start it or end it, and you are closing the hearing season. So we welcome you today. We look forward to your testimony.

And I would like to recognize our ranking member and my colleague, Jo Ann Emerson.

Mrs. EMERSON. Thank you, Chairman. Welcome, Secretary Geithner. I am glad you are able to be with us this morning, and welcome to the committee. In the Nation's current economic condition, you, as we all know, have a very challenging task that includes reinvigorating bank lending to consumers and small businesses, stabilizing the housing markets, saving the American auto industry, and most importantly, protecting the American taxpayer, their investments, and preserving the long-term financial health of the Federal Government. I know that you and your staff have been working extremely hard on these issues, and we appreciate the dedication of all of you. Like many of my Republican colleagues who voted for the TARP last fall, I am disappointed with the former administration's allocation of the funds.

Providing banks with hundreds of billions of dollars, borrowed dollars I might add, with little accountability or transparency was not what the Congress thought it was authorizing when we passed the Emergency Economic Stabilization Act. And let me tell you that I come from a very rural district in southeast, south central Missouri, and it is quite difficult to explain to my constituents why banks have received billions of dollars without being required to increase lending, account for the funds they received, or take meaningful steps to limit executive compensation. In February you released the new administration's plan for using the remaining TARP funds. At the time, this plan had few details and was not met with great confidence by the American people or the markets.

Many questions and concerns still remain about your plans to address issues such as growing home foreclosures, limiting executive compensation, the Federal Government's ownership of common shares of banks, the future of the American auto industry, finding ways to increase small business lending, and eliminating toxic assets from balance sheets. In addition to administering the TARP programs, you all at Treasury have many other responsibilities, including acting as the government's bookkeeper, producing the country's coins and paper money, administering the government's debt, assisting citizens in filing their taxes, and pursuing those who do not pay their fair share, as well as performing important work involving terrorist financing and money laundering.

Regarding the administering the government's debt, yesterday we discussed with Director Orszag the same issue. And I am concerned with the administration's fiscal year 2010 budget, because it projects a deficit in 2009 of $1.8 trillion, and projects continuing deficits for the foreseeable future. My concern and the concern of so many of us is where will these funds come from? China, Saudi Arabia, sovereign wealth funds. Will this public borrowing crowd out investment in the private sector, slowing the recovery? Who will ultimately pay for this borrowing? Our children, your children, our grandchildren? What are we doing to the future of the financial health in the long term for this country?

In conclusion, you do face great challenges in managing the Federal Government's finances and in attempting to reinvigorate the economy. I look forward to working closely and collaboratively with you, Chairman, and the rest of this committee to address these difficult matters. So thanks for being here.

Mr. SERRANO. Thank you. The committee is honored to have with us our chairman and our ranking member, Mr. Obey and Mr. Lewis, notwithstanding the fact that they bring about butterflies in Emerson's and Serrano's stomach, because we have to sound smart and look good, and they take notes and they report back to themselves.

Ms. WASSERMAN SCHULTZ. You always look good.

Mr. SERRANO. Thank you. So I would like to recognize our chairman, Mr. Obey.

Mr. OBEY. Thank you, Mr. Chairman. It is getting a little deep in here. Let me simply, Mr. Secretary, let me just put it to you this way: Two points. Number one, I watched Senator Tester yesterday in an exchange with you about the auto industry. And he is a plain-spoken man. And I admire that greatly. And essentially, what he said, and it is something I totally agree with, I am very interested in seeing a healthy auto industry remain in this country, but I am not interested in providing one damn dime to any company like General Motors who decides that as part of their reorientation operation, they are going to be closing plants in this country and moving them to Mexico or any other foreign country.

There is a limit to the toleration of taxpayers and voters when it comes to accepting the realities of globalization. And one of the realities that the auto industry is going to have to accept is that if they expect to receive taxpayer support and government solicitude, they need to demonstrate their loyalty, if you will, to American workers and to the American job front.

Secondly, I chaired the Foreign Operations Subcommittee for 10 years. And I pushed through this Congress a lot of funding for the IMF. But I have to tell you I am very, very reluctant to support any additional funding for the IMF in the supplemental as long as the Europeans continue to be as modest as they are in terms of their actions on the stimulus front. I understand the traditional fear of the German Central Bank about inflation. I understand what they went through before Hitler came to power. I understand all of that. But it seems to me that if we are being asked to borrow money by the worldwide community in order to stimulate our economy that we do not want Uncle Sam to be Uncle Sucker. And I, for the life of me, do not understand why the Germans are so reluctant to support a more aggressive stimulus package. Because if their economies do not recover, our economies do not recover, because we cannot sell to them what we ought to be selling to them.

And I would like your honest assessment whether you think they are stuck in last century's fears or whether they are going to recognize this is a new reality again. Thank you very much, Mr. Chairman.

Mr. SERRANO. Thank you. Mr. Lewis.

Mr. LEWIS. Welcome, Mr. Secretary. You have taken on, to say the least, major challenges. I do not have any opening statement that is of a formal nature. They tell me that Alexander Hamilton thought you had the most important job in the Federal Government next to the Presidency. And indeed, if challenges are a part and parcel of carrying out that responsibility, you have them. I look forward to having a chance to ask questions. Thank you.

Mr. SERRANO. Thank you. Mr. Secretary, we always ask our witnesses to keep their testimony down to 5 minutes. And your full statement will go in the record. So please proceed.

Secretary GEITHNER. All right. Thank you, Mr. Chairman, Ranking Member Emerson, and members of the subcommittee, Chairman Obey, it is an honor to be here with you today. I am sorry that I was not here first in your list of hearings. That would have been an honor too. But I am pleased to be here, and I look forward to working with you. We are going to need your support, I hope to have that support, and I want to have a close, productive working relationship with this committee, this subcommittee. It is very important for the Department. And I hope you give me a chance to work with you closely on these issues.

My opening statement is about our budget, not about the financial system, financial recovery efforts, about the IMF or autos, but I would welcome a chance to talk to you about all those questions. I am happy to discuss any issue before the country. These are challenging times. President Obama and his administration are working to meet these challenges by getting Americans back to work, trying to get our economy growing again, by recognizing the imperative of getting our fiscal house in order, bringing our deficits down on time to more sustainable levels, by making long neglected investments in health care, energy, education that are necessary to improve the productive capacity of our economy over the longer term, and to enhance our competitiveness in this global economy.

To achieve this, we must repair and reform our financial system so that it works in favor of recovery rather than against recovery. We need to support growth and meet our long term fiscal goals. We must redesign and bolster enforcement of our Tax Code so it is both fairer and more efficient. To advance our interests globally, we have to work with other nations to promote economic recovery and to ensure more open markets for U.S. businesses, a more balanced, sustainable global recovery over the longer term. And to protect our national security interests, we need to continue to use all the tools at our disposal to exclude terrorists, proliferators, other illicit actors from using our financial system to advance their interests.

The fiscal year 2010 budget before you today will allow the Treasury to pursue these core missions. The $13.4 billion request includes a 676 million, or 5.3, percent increase over enacted 2009 levels. Of this, and let me just give you a few brief highlights: 14 million would go to bolstering and increasing the staffs of our domestic finance and tax policy offices, which are at the center of, as you know, the challenges facing our country in the financial system and on the fiscal front.

We included a $137 million request to more than doubling our CDFI fund to ensure that the benefits of financial repair reach beyond our major banks and to businesses in economically distressed communities. These communities were underserved by our financial system even before the current crisis, and they have been deeply hurt by the job losses, foreclosure crisis, business failures that the crisis has spawned. We propose a total of $332 million devoted to the new Internal Revenue Service enforcement efforts, including 128 million to add nearly 800 new IRS employees to combat offshore tax evasion and improve compliance with U.S. international tax laws by business and high income individuals.

Another 130 million would go to bolster the security of IRS information technology, to improve the efficiency of its business systems, and to upgrade its fraud detection capabilities. Although not directly under the jurisdiction of this subcommittee, our budget also includes funds to meet our international obligations in the international financial institutions, again to help us mount an effective global response to the crisis, which is so important to our recovery. As we seek these additional funds to respond to our Nation's troubles, we have cut back on some programs that are either ineffective or can be safely delayed. As to just one example, even as we seek to increase capital investment for the IRS, our budget would reduce the Department-wide capital investment account by 65 percent, for a savings of $17 million.

Now before I conclude, I just want to say a word about the Treasury Department staff. I have had the honor now of leading a team of smart and dedicated individuals who are working exceptionally hard to make our government more effective, our society more just, who are following a long tradition of debating policies openly and courageously on their merits, doing what is right, not what is expedient, and drawing on the best ideas and expertise available across the nation. They are performing a great service for the country under very challenging circumstances, and I am grateful to them. As I said, it is an honor to serve with them again.

Treasury is, of course, responsible for promoting the Nation's prosperity and protecting its financial security. We advance our interests around the world through the strength not only of our economy, but the quality of ideas, by the commitments we demonstrate through our actions. At other times in our history, when the economy was growing on its own and markets seemed capable of regulating themselves, these duties might have seemed comparatively routine, but these are not such times. The President and the Treasury Department have already begun the hard work of recovery and reform. Our budget will help us pursue these critical goals, and we hope to earn your support and cooperation as we go forward. Thank you, Mr. Chairman. I would be happy to answer your questions.

[The information follows:]

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Secretary Timothy F. Geithner
Opening Statement
House Committee on Appropriations
Subcommittee on General Government and Financial Services
May 21, 2009

Chairman Serrano, Ranking Member Emerson, members of the Subcommittee, I appreciate the opportunity to testify before you for my first time as Treasury Secretary on the President's Fiscal Year 2010 Budget request for the Department of the Treasury.

We live in challenging times.

President Obama and his Administration are working to meet these challenges by getting Americans back to work and getting our economy to grow again; by putting our fiscal house in order to sustain recovery once underway, and by making the long-neglected investments in health care, energy and education necessary to enhance America's global competitiveness and produce a more balanced, sustainable growth over the long-term.

Treasury's Key Priorities

To achieve this new growth, we must repair and reform our financial system so that it works for, not against, a recovery that serves all Americans.

To support growth and meet our fiscal goals, we must redesign and bolster enforcement of our tax code so that it is both fairer and more efficient.

To advance our interests globally, we must work with other nations to promote economic recovery and financial repair, and to ensure more open markets for U.S. business.

And to protect the country, we must use all of the tools at our disposal to exclude terrorists, proliferators, and other illicit actors from the international financial stage, and thereby secure our financial system and combat threats to our security.

The Fiscal Year 2010 Budget that you have before you will allow Treasury to pursue these core missions assigned to the Department by the President and the Congress. The $13.4 billion request includes a $676 million, or 5.3 percent, increase over enacted 2009 levels.

Of this increase, $14 million would go to bolstering the staffs of our Domestic Finance and Tax Policy offices, which are at the epicenter of Administration efforts to repair and reform the financial system and to re-design and improve our tax policies and tax code.

Some $137 million would be devoted to more than doubling our Community Development Financial Institutions (CDFI) Fund to ensure that the benefits of our financial repairs reach beyond our major banks and businesses to help economically distressed communities. These communities were underserved by our financial system even before the current crisis, and have been deeply hurt by the job losses and business failures that the crisis has spawned.

A total of $332 million would be devoted to new Internal Revenue Service (IRS) enforcement efforts, including $128.1 million to add nearly 800 new IRS employees to combat offshore tax

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evasion and improve compliance with U.S. international tax laws by businesses and high-income individuals. Another $130 million would go to bolster the security of IRS information technology, improve the efficiency of its business systems and upgrade its fraud detection capabilities.

Although not directly under the jurisdiction of this Subcommittee, our Budget also includes funds to meet our international obligations in order to help mount a global response to the crisis and revive mutually reinforcing growth around the world.

As we seek these additional funds to respond to our nation's troubles, we have cut back on some programs that are either ineffective or that we believe can be safely delayed.

For example, while the Earned Income Tax Credit (EITC) continues to be one of the most effective anti-poverty programs that the Federal government administers, the Advanced EITC, a related program, which provides benefits in advance of filing a tax return, has been prone to exceptionally high levels of error and low use by those eligible for it. Accordingly, our Budget proposes to end this latter program for savings next fiscal year of $125 million.

Similarly, even as we seek to increase capital investment for the IRS, our Budget would reduce the Department-wide capital investment account by 65 percent for a savings of $17 million.

Our Budget would reduce from 20 to 16 the number of positions for international economic attachés to keep us apprised of developments around the world, saving $2 million next fiscal year. It would absorb a portion of our non-pay inflation through more efficient use of contracting and other cutbacks, saving $18 million. It would take advantage of the growth of efficient electronic filing of tax returns to reduce the IRS processing budget by $8 million next fiscal year.

Given that we have had control over the budget for fewer than five months, the reductions I have just described represent an attempt to do more with less. As we begin work on the Budget for Fiscal Year 2011, Treasury has prepared itself for a more rigorous assessment of its spending.

I have already issued guidance to Treasury senior staff that says, in part: "To afford any new investments, we will have to take new approaches to solving old problems. I expect each bureau and policy office to identify opportunities for innovation that will transform how Treasury fulfills its missions in order to both improve performance and reduce cost."

In addition, the President has announced his intention to nominate Dan Tangherlini to be our Assistant Secretary for Management. Consistent with the President's mandate, I will look to Mr. Tangherlini to scour the Treasury budget for efficiencies and cost savings. He comes to the job with an impressive track record of working on budget issues with District of Columbia Mayor Adrian Fenty, and I am convinced that he will bring the same results-oriented approach to the federal government.

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Repairing and Reforming the Financial System

The President assigned Treasury to repair and reform the financial system so that it supports recovery, doing so in a way that serves the entire country. We have taken steps to address the problems of every major element of the system and to fill the system's gaps so that all Americans benefit.

Most recently, federal banking supervisors announced results of the stress tests that we asked them to conduct on our 19 largest banking institutions. The aim of these assessments conducted was to ensure that these institutions have sufficient capital buffers to absorb the losses that they could suffer under worse-than-expected economic conditions and continue to make the loans necessary to sustain recovery.

Overall, the tests showed that the core of our banking system is in less dire shape than many had thought. However, 10 of the 19 banks need to raise extra capital over the next six months. In cases where banks have trouble raising the necessary funds, Treasury is prepared to step in with investments through our Capital Assistance Program.

In addition to efforts to stabilize the banking system, Treasury is at the forefront of Administration efforts to bolster both our housing markets and our critically important securitization markets for both new and old asset-backed securities.

In housing, we have helped drive mortgage interest rates to historic lows, and are helping responsible homeowners to refinance into more affordable mortgages or to modify their at-risk loans to avoid preventable foreclosures.

We have begun to boost new consumer and business lending by re-starting the markets for asset-backed securities that financed almost half of all lending in this country before the crisis. There have been more securities of this type issued in the last three months than in the preceding eight.

Additionally, Treasury is about to join with private investors in seeking to restart the markets for legacy mortgage loans and securities that are now stuck on bank balance sheets, keeping these institutions from making new loans to families and businesses.

As we have taken these steps, we have understood that repair alone is not enough. We must also reform our financial system so that it is less prone to crises of the dimensions we now face. We have made a good start on this effort.

We have announced a framework for new systemic risk regulations to ensure that no large and interconnected firm or market will take on so much risk that their failure could destabilize the entire financial system. This framework would also give the government the authority to resolve those institutions that do fail in ways that protect system stability. We have recommended new consumer and investor protections. We will soon propose streamlining our out-of-date regulatory structure so that it matches the size, shape and speed of our modern financial system.

Key elements of our financial repair efforts are being covered by the $700 billion Troubled Asset Relief Program (TARP). Treasury has no plans to request additional funding for direct management of the program, which was provided for under the Emergency Economic Stabilization Act approved by the Congress last fall.

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That management is being handled by our Office of Financial Stability (OFS), which is focused on ensuring that TARP funds serve the public purpose of stabilizing the financial system; that they are fulfilling this purpose in ways that protect taxpayers; and that we can provide a clear account to the Congress and the American people about the effectiveness of the funds' use.

In order to administer TARP and ensure compliance by TARP recipients, OFS has had to quickly assemble a substantial staff. OFS staffing levels, which were at 88 when I arrived in office, rose to 147 by last Monday. They are expected to rise to 165 by the end of this month and to 225 by next fiscal year. The office's budget for next fiscal year will total $262 million, a 6 percent decline from the current fiscal year's $279 million. The change is largely due to a decline in estimated spending on contracts as part of the program's initial start-up.

While TARP is proving effective at improving the immediate stability of the financial system, the scope of the issues that this Administration and this Department face extend beyond TARP to include striking the delicate balance between intervention and allowing market participants latitude to operate; devising a new financial regulatory structure for the future; and working through the tough problems of what form our government-sponsored enterprises, Fannie Mae and Freddie Mac, should take as we emerge from this difficult period.

All of these issues fall to Treasury's Office of Domestic Finance, which, working with OFS, is having to operate on new policy terrain, tackling problems that the country has not faced in generations and for which we have few guideposts in our immediate past.

That is why the workload of the Domestic Finance office has already expanded greatly, and is all but certain to expand still further. And it is why we are seeking to modestly increase its size and bolster its expertise in several critical areas.

Our Budget requests an additional $8.7 million for the office to add 26 full-time equivalent (FTE) positions to the staff. This represents a 26 percent increase from the office's current fiscal year staffing of 101.

The additional funds will be used to create two new Deputy Assistant Secretary positions, one for housing finance, small business and consumer issues, and a second for capital markets. These two new officials will lead teams that will perform the economic and institutional research necessary to ensure that we understand all of the policy options in each of these areas and choose the most effective ones for solving our problems.

As we seek additional funds for Treasury, we must also seek them for the front-line institutions that will sustain our economic recovery and ensure that its benefits are broadly shared.

Our Budget would more than double the resources of the Community Development Financial Institutions (CDFI) Fund to $243.6 million. The fund's mandate is to help low-income, economically distressed communities that were poorly served by our financial system even in economic good times, and – although they had nothing to do with causing current conditions – have been significantly hurt by the economic and financial fallout of the crisis that we now face.

The $136.6 million, or 128 percent increase in funding, would allow this program to support financial institutions in making job-creating investments and in providing access to capital in communities that are often considered too risky for mainstream financial institutions to serve. By

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targeting lenders and borrowers in these communities, the Fund would help some of our most vulnerable populations weather the crisis and benefit once recovery is underway.

The aim of the fund is to make sure that we provide distressed communities with more than simply government grants and aid. We must also build the capacity of their local financial institutions to ensure that capital is flowing to homebuyers and businesses so that they can finance their own economic futures. Since its inception in 1994, the fund has directed nearly $1 billion to distressed communities, and allocated $19.5 billion in tax credits through its New Markets Tax Credit program.

Financial institutions funded through the CDFI program make loans to small businesses and micro-enterprises and take equity positions in them. They provide mortgages to low-income homebuyers, and finance developers of low-income housing and community facilities, such as charter schools, health clinics and child care centers.

One example can be seen right here in the Anacostia neighborhood of Washington, DC. City First Bank – a local CDFI – and Charter Schools Development Corporation partnered to provide a $13.3 million New Markets Tax Credit for the Thurgood Marshall Academy, the city's first charter school focused on law, serving 360 students in grades nine through twelve and achieving a 100 percent college acceptance rate for its first three graduating classes.

Historically, the CDFI program has been heavily oversubscribed and has had to turn away qualified applicants. For example, in the current fiscal year, the program for CDFI financial and technical assistance awards, and is now budgeted at $55 million. Moreover, it expects to receive applications for more than $500 million in funding.

Redesigning the Tax System for Fairness and Efficiency

The President has asked Treasury to redesign and bolster enforcement of our tax code so that it supports growth, sets the stage for our return to a sustainable fiscal path, and accomplishes these goals in a manner that is fair, efficient and supportive of our society's broadest goals.

To make good on the President's assignment, our Budget requests a modest increase in funding for Treasury's Office of Tax Policy and more substantial increases to expand IRS enforcement activities and to improve its information technology.

Treasury has moved quickly to implement the more than 30 tax provisions of the President's economic recovery plan. Treasury also played an integral role in designing the tax provisions of the President's Fiscal 2010 Budget, and it will play a similar role in implementing them.

The President has made clear that he will not seek any major revenue increases until 2011 when the recovery should be firmly in place. He has, however, been equally clear that once recovery is underway, we must get our fiscal house in order or risk having government borrowing crowd out productive private investment. Treasury and the White House will work with Congress to make the tax changes that are necessary to reduce deficits and to do so in a manner that is fair to all Americans.

As part of our efforts to make sure that the tax system is working for recovery and is operating fairly, we have designed new policies to curb the use of off-shore tax havens, close the

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international tax gap, remove tax incentives for companies to shift jobs overseas, and replace these incentives with ones that encourage creation of jobs at home.

Our tax work on the recovery plan, the Fiscal Year 2010 Budget, and these international tax issues are just the beginning of an ambitious agenda for this Administration.

On health care, the President has made clear that the road to fiscal discipline and to solvency for Medicare and Social Security run through overall health care reform. Although much of the cost of the President's reform plan will be covered by savings from the system, we will need to design programs to cover some of the costs in ways that are fair to all Americans and do not harm the economy. Treasury is deeply involved in this effort and in the related work to expand coverage and improve our health care system in other important ways.

On retirement and economic security, Treasury and, in particular, the Office of Tax Policy, is taking the lead in developing and actively working with Congress to flesh out the initiatives proposed in the President's budget to help enhance retirement security and savings for the half of working Americans who have no retirement provisions beyond Social Security. These proposals would make it easier for people to save for their own retirement, either through their workplaces or on their own, and would move us toward universal retirement savings coverage.

On climate change, Treasury is already working closely with Congress to design the auction mechanisms that will be needed to implement the Administration's greenhouse gas cap-and-trade program.

Our Office of Tax Policy has been deeply involved in all of these issues from the outset of the Administration. Like our Office of Domestic Finance, its workload already has substantially increased and is certain to grow as the health reform, retirement security and climate change debates get underway in earnest.

At the moment, the Office of Tax Policy's career staff includes 30 lawyers and 44 economists as well as support staff for an overall staffing level of 93. This is lower than its usual complement of over 100 professionals.

Our Fiscal Year 2010 Budget would increase the office budget by $4.9 million to add 15 full-time equivalent (FTE) positions in order to increase overall staffing to 108, and would therefore represent a return to historical norms. The additional staff is needed to perform analysis and revenue estimates for new policy proposals, conduct research for, among other things, congressionally mandated studies, and develop regulations and guidance for new legislation.

The vast majority of the new funds that we request in this Budget are for improving the enforcement efforts and the information technology of the IRS.

As I have said, $332 million would go to new IRS enforcement efforts, including $128.1 million to improve international tax compliance. The balance of these funds would be used to support three critical programs: 755 employees to increase examinations of tax returns for businesses and high-income individuals; 300 employees to expand the IRS document matching program, which

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compares tax returns to other forms such as W-2s and 1099s; and an additional 491 employees to improve collection operations and build two new IRS automated collection center sites.

Turning to IT, our Budget requests a $90 million increase in funding to protect taxpayers' personal records from the increasing number and sophistication of Internet-based attacks. With these funds, the agency will deploy state-of-the-art, automated tools to improve record access management, risk assessment and system auditing. This effort would address concerns noted in the past by both the Government Accountability Office and the Treasury Inspector General for Tax Administration.

Our Budget also requests an additional $18 million for systems to help the IRS return review program detect noncompliance and fraudulent refunds, and a $22 million increase to continue modernizing the agency's core taxpayer account database and modernized the e-File web-based platform.

Reengaging with the World on Economic Issues

The President assigned Treasury to ensure that this country reengages with the world, not just on issues of war and peace, but also on those issues that are crucial to our common economic futures.

This is a global crisis. Recovery here depends on recovery abroad. We are working closely with other major economies to put in place the fiscal stimulus and make the financial repairs necessary to ensure U.S. and global recovery. Our financial reform effort in the United States must be matched by similarly strong efforts elsewhere in order to succeed.

We are seeking to mobilize the financial resources of the better-off nations to help the emerging and developing economies that have been especially hard-hit by this crisis. We are doing this for more than simply humanitarian reasons; as recently as last fall, these economies accounted for fully 42 percent of all U.S. exports.

Last month, the President and leaders of the other G-20 nations agreed on the need to make more than $1 trillion in financial resources available to support global growth and trade.

Those funds include our commitment of up to $100 billion for an expanded New Arrangements to Borrow, a permanent back-up mechanism that provides the International Monetary Fund with supplemental resources to help emerging markets and developing nations weather the crisis.

As part of our effort to rekindle global growth for the sake of our own recovery, we are seeking to meet our past and present financial commitments to the multilateral development banks that help emerging and developing countries.

Although the funds to do this are not directly within the purview of your Subcommittee, I mention them to illustrate how Treasury's entire budget is tailored to let us fulfill the missions that the President has set out for us. Our budget request includes $2.5 billion for international programs, most of which would serve to meet our past and present commitments to the multilateral development banks.

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Conclusion

Before I end, let me say a word about the Department's staff. I have the honor of leading a team of smart and dedicated individuals who are working to make our government more effective and our society fairer, who are following a long tradition of debating policies fearlessly on their merits, doing what is right and not what is expedient, and drawing on the best ideas and expertise that are available. They are performing an incalculable service to our country in these challenging times, and I am immensely grateful to them.

The Department of the Treasury is responsible for promoting the nation's economic prosperity and protecting its financial security. We advance our interests around the world through the strength not only of our economy but of our ideas.

At some other time in our history, when the economy was growing of its own accord and markets seemed capable of regulating themselves, these duties might have seemed comparatively routine. But these are not such times. This President and Treasury have already begun the hard work of recovery and reform. Our Fiscal Year 2010 Budget will allow us to pursue these critical goals, and deliver the balanced and sustainable growth that the American people seek and deserve.

Mr. SERRANO. Thank you, Mr. Secretary. Mr. Secretary, prior to your written statement you mentioned the fact that you needed to have a good working relationship with this committee. And I certainly understand the need to have a good relationship with every Member of Congress, with this committee, and this subcommittee in particular. So what I want to do now, before I move onto a discussion with you, is just to get out of the way the one unpleasant, perhaps unpleasant question I had, and that was in the 2009 omnibus bill, there was language that this subcommittee included jointly with the Senate, Senator Durbin, which spoke to agricultural and medical sales to Cuba. And in a desire to get two Senators to vote for that bill, you issued a letter, unbeknownst to me, or to this committee, basically saying that what we intended to do was not going to take place, and that they could rest assured that that was not going to take place.

That was not good. That was not a good way to start a relationship, because I take very seriously article one of the Constitution that says that Congress dictates what the law will be, and it is your role to carry it out. And so I was distressed to see that you basically were telling two senators if you vote for this, I promise you this is not going to take place, when I had intended, and Senator Durbin had intended, for it to take place. So my question to you was, was it that you did not understand the intent of what Congress was trying to do? After all, this was a bill agreed to by the Senate and the House, and was on its way to the President's desk. Or was this an administration's desperate need to pick up two votes?

Secretary GEITHNER. Mr. Chairman, thank you for raising this. I understand how strongly you feel about this. And thanks for giving me a chance to respond to your concerns on this. I know you have worked on these issues for many, many years, and I admire your leadership on these issues. And I think you are finding we are at a time now where we have a chance to move together on many of the things you worked very hard for.

Now, in this particular context, with respect to the concerns you raised about this letter, what I did was explain how the Department interpreted the law, clarified our interpretation, same interpretation we have had for some time. It was a consistent statement of how we interpreted the law, and that is my obligation, as you know.

Now, I understand your concerns with this. And I want to say today before you, we would be happy to work with this committee and with the authorizers to seek changes in the law that would allow us to meet the concerns you have supported and pursued for some time. I do not know what is going to be possible in that context, but I would be happy to work with this committee and the authorizers on ways to figure out a way to move forward and to address your concerns in this area.

But what I did in this letter is just simply explain what has been Treasury's interpretation of what the law requires. And we came to that judgment very carefully. We were very thoughtful in doing it, but it was a consistent interpretation.

Mr. SERRANO. And I understand that. And even on this committee not everyone agrees with me or with Ms. Emerson, who agrees with me, on how we should go forward. But I think we all agree that if any Member here gets the committee to accept language or dollars that then you have to carry out that. And so my concern at that time, and I will drop the subject because I am not interested in pursuing it any further, at that time was that the administration was basically saying it does not matter what the Congress said, we, in order to pick up two votes to pass this bill, will tell these two Senators that that issue is dead.

And that troubles me, because it could happen on any of the issues that Mr. Obey brings up, on any issues Ms. Emerson or Mr. Lewis brings up, and that is not the practice. So you said—you answered the next question I was going to ask you, was on any issue when you feel that there is a difference, please discuss it with us before you issue letters and embarrass the heck out of me in the Spanish press.

Let me move on to more pleasant things. We understand that the financial services authorizing committees and the administration are giving serious consideration to creating a new agency to address consumer problems with financial services. Such a commission might be started in the next fiscal year, and it would fall within the jurisdiction of our Financial Services Subcommittee. Can you share with us your thoughts about what a commission might look like, how much it would cost to run, how large a staff would be required, and how it should be funded?

Secretary GEITHNER. Mr. Chairman, as you know, the President is committed to working with the Congress this year to enact comprehensive reform of our financial system, to put in place a much stronger form of protections for consumers and investors, and a range of other reforms to make our system more stable in the future, less vulnerable to this crisis. And as part of that, we have outlined in the public a series of substantive proposals in the areas of reducing systemic risk, bringing oversight to derivatives markets, improving credit card protections for consumers, now enacted into law pursuant to the work of your colleagues in the Congress.

And we are going to lay out to the public and to the Congress in the next several weeks a broad set of comprehensive reforms. As part of that, we will make some proposals for how we change the oversight structure. This country has lived for some time with a very complicated, very segmented, archaic framework of oversight over our financial system. And that is one reason why this crisis was so severe, one of the reasons why consumer protections were evaded so easily. And that is something we are going to have to change. As part of that, you are correct, we are examining the merits of setting up a new independent commission or agency to help provide stronger rules to protect consumers and better enforcement of those rules. We are not at the point yet, though, where we have made a judgment on what precise structure or form this should take, how broad its authority should be, how it relates to the existing authorities that exist across agencies now. But we look forward to a chance to laying out our proposals for you when we are ready.

And I think it will probably take us a little longer to address the questions you raised, which is how to fund it, how large is it going to have to be. We are starting to think through those questions now, but as you know, those very complicated, consequential questions. The funding in particular is difficult because of the complications created by some of the existing funding mechanisms for supervisory authorities.

So we are beginning to work through this. But the objective is, which is the most important thing, is that we have better designed rules to protect consumers, that are enforced much more effectively and evenly across the entire financial system.

Mr. SERRANO. And what is your timetable to come to us?

Secretary GEITHNER. We are, of course, working closely with the banking committees, other relevant committees in this context. But we expect to lay out in public within the next several weeks a broad set of proposals not just for the substance of the rules of the game, but for the oversight structures to enforce those rules.

Mr. SERRANO. Well, thank you. We have great attendance at the committee today, so I will stop now and turn to Ms. Emerson.

Mrs. EMERSON. Thank you, Mr. Chairman. Let me just put in my one bit of comment on the original issue that Mr. Serrano brought up with you, particularly in light of your comment about the desire to open up markets. And certainly Cuba has been a market that has great potential and has served us well so far. But I just want to point out, and this has bothered me for some time, and unfortunately you are now the recipient of this, having worked over the last several years with the Treasury Department on this issue, and having been one of the authors of the original bill, some folks at the Treasury Department have told me that they were interpreting the intent of Congress.

And when they are telling me that they are interpreting my intent, and it is not being interpreted properly, it is really rather problematic. So I just say that. And hopefully, we will be able to work on this issue and get it done. But now I will talk about other Treasury things. The fiscal 2010 budget estimates that banks will return about 25 billion in TARP funds this fiscal year. And I think you all made a statement about that sometime earlier this week. And that the funds would or could be used to make investments in community banks.

When Congress authorized the TARP program, we were led, as I said earlier, to believe that the program would purchase troubled assets. And I believe that members did not think that the proceeds from the sale of assets would then be used to purchase additional assets. So my three quick questions are these. One, do you believe that the Treasury has the authority to use funds returned by the banks to purchase new assets rather than perhaps to pay down our debt or pay down our deficit?

Number two, if you believe Treasury does have the authority to purchase new assets with returned funds, is the TARP going to go on forever? And the last question I have is will this administration or future administrations have the ability to recirculate the TARP funds over and over again in order to nationalize or partially nationalize additional businesses and industries beyond banks, insurance companies, or the auto industry?

Secretary GEITHNER. To go in reverse order, then I will do details, no, no, and yes. So let me try and go through them. We believe as the law is written, and we spent some time thinking through exactly how the law is structured, and I addressed this in some detail in public yesterday, that a dollar that comes back to the Treasury repaid by a bank goes into the general fund, available to reduce our debt. But it also increases the head room available under that authority and gives us the flexibility, if we think there is a strong case for doing so, to use that additional resources to support the programs we put in place. That flexibility is designed in the law. And I think it is a prudent, important thing to retain, because we are still in a, you know, a very challenging economic and financial situation.

It is very hard to know what is going to be necessary and possible going forward. We would like nothing better than to have all those resources go into general fund, reduce the debt. But I think prudence requires that we use the flexibility the law provides to reinforce these programs, which are designed to get credit available to businesses and families across the country. Now, the law does sunset. I believe the Secretary of the Treasury has the ability under the law to extend it beyond its initial expiration for an additional 9 months. But I do not have the authority to extend it beyond that. So it is not a permanent program. So we cannot permanently recycle these programs. And it is not our objective, and I would never support a program designed to, as you questioned, a program designed to allow us to nationalize banks or other businesses as a matter of policy. I would never support that.

It never should be the objective of the United States Treasury to do that kind of thing. What our obligation, though, is, is to try to make sure we get this economy back on track as quickly as possible and we get this financial system repaired and working again so it is not damaging the fortunes of American businesses and people who want to borrow to put their kids through college. And these programs are designed carefully to try to get credit flowing again where it is necessary, so again, we have recovery come as quickly as possible. That is our reading of the statute, though. And I know there is some questions about the way it was designed, but we have looked at it very carefully.

We checked that interpretation with independent people. And we think that is the way the law is written.

Mrs. EMERSON. Thank you.

Mr. SERRANO. Before I recognize Mr. Obey, let me just say that I agree with his comments about bailing out corporations that are then going to use some of that money, if not all of that money, to go elsewhere. You know, no one bails out little grocery stores. In my district, we have something, as you know, called bodegas. And bodegas were opening up on every block. Now for the first time in all my years in New York they are closing down. If you were to bail them out, they would open up in the same place, down the block, rehire the same people. But to bail out major corporations who then go to Mexico or elsewhere is a major problem. And I join Mr. Obey in that concern. Mr. Obey.

Mr. OBEY. Mr. Secretary, I would just like to talk to you for a bit about the general role of Treasury in the government and in the economy. And I raise this because I am very concerned that over the long haul, our long-term debt situation is simply not sustainable. I fully supported, and in fact, I think we need an even more aggressive effort at stimulating the economy short-term than we have engaged in. But I am very concerned that in the long-term we are simply not going to be able to get our debt into manageable levels as long as we do not have a healthy increase in the earning power of average American workers. And so that is what leads me to ask. I do not know if it is a question or simply making a point.

We do not normally think of capitalism as being a system under which the government shovels money into the banks and shovels money into corporations. It is an emergency situation. And we have to do it, but we do not like it. But I would urge you to look at the Treasury Department and its responsibilities in a far more expansive way than has been the case in the past. Workers are being asked to swallow the idea that the government is going to shove billions of dollars into the high rollers in this economy. And they are being told that that is necessary to save the system. But unfortunately, some of the same beneficiaries of that in our society, when people talk about trying to shield workers from some of the more nasty consequences of globalization, their response is, 'no, no, no, we have got to let the free markets work.'

Well, with all due respect, right now we are not experiencing the free markets on Wall Street or other high places, but we certainly are on Main Street. And so I would simply ask that you, during your tenure, use the Treasury Department as an agency that serves as a spokesman for everybody in this society, not just the top dogs. And that means we have to be just as aggressive in looking for ways to stabilize the wage situation, the family security situation, the pension situation for private average families as we are for the biggest guys on the block. I know that is heresy to some of the establishment in this economy, but I think Treasury has—it is not just the Labor Department that is supposed to give a damn about average workers in this place. And I would simply say that unless we get a better balance, the idea that workers simply have to take what is going to come in the globalized market, while big guys are too big to fail and so they can get help, that is not a sustainable economic model because it is not a sustainable political model.

And so I just urge you, for whatever it is worth, to take that kind of view of your agency's responsibility. Other than that, I would simply like to have a comment from you on my comments on the German Central Bank and the IMF and the Europeans' reluctance to go as far as I think they should do with respect to their own economic stimulus.

Secretary GEITHNER. Mr. Chairman, let me just say at the beginning that I completely agree with what you described as the appropriate role of the Treasury in thinking about laying the foundation for a more sustainable, more balanced, more productive economy where the gains are broadly shared across the spectrum. When I last served in the Treasury, which was in the 90s, we had a period where we had very responsible fiscal policies help induce a large sustained increase in private investment, strong productivity growth, and much more broadly shared gains of that growth across the American economy.

And I think that shows how important it is to look more broadly at how you design economic policy, because you are going to get more sustained, more productive growth, more evenly shared if you bring that mix of long term fiscal responsibility, investments in things that will make our economy more productive over time. Now, just to underscore our commitment to this, the Senate confirmed 2 weeks ago Alan Krueger, Princeton economist to be Assistant Secretary of Economic Policy at the Treasury. And Alan's life's work is in the areas you referred to, in labor market policies, a range of things in that area. And so we are very much in support.

I know the President, as you know, the President is very committed to trying to make sure that we create the conditions for a more balanced, more sustainable economy over time as we address this crisis. And you are right that we have this huge obligation to work with the Congress to bring our fiscal deficits down over time to a more sustainable level. Now, right now the most important thing we could do towards that objective is to fix the crisis we inherited. That requires in the short term more stimulus, more support to prepare our financial system. But that is the only way to get growth back, the only way to make sure deficits are lower, not larger in the future. But that has to come with a very clear commitment to bring those deficits down over time. Now, on the important thing about the international imperative, absolutely our efforts to promote recovery here will be less effective if we do not get other countries moving with us to support demand and growth in their economies. And the President went to London about 6 weeks ago and got broad agreement among the major economies, including the Europeans, to provide the largest, most coordinated support in terms of fiscal policy that we have ever seen. And as part of that, the major European economies are doing very substantial stimulus in 2009. What distinguishes their approach today from ours is the stimulus package that the Congress designed with the President provides for more support sustained over a 2-year period of time. The Europeans have a somewhat different system. And they have been reluctant to commit at this stage to lock in now additional stimulus for 2010 partly because their systems are different.

But my sense is the whole context has changed. A year ago, 6 months ago people were debating whether this is a crisis or not. They thought it would be contained to the United States. The world would be insulated from it. No one takes that view now. Their economies are going through as challenging periods, in many ways more challenging in some things than ours, and I think that has led to greater recognition about the imperative in Europe for more aggressive action. You are seeing it. We want to make sure it is sustained and strong enough so that it is reinforcing our efforts. And you are right to underscore that point.

So I think it is slightly better than you think. But what is important is that it be sustained and that all governments are watching carefully about the impact of their policies and see if they will need to reinforce them.

Mr. OBEY. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you. Mr. Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman. Mr. Secretary, I read with some interest Treasury's response initially to what around this place was our mutual bipartisan desire to have the average American family have access to the American dream, that is the opportunity to own a home. Everybody knows that is a part of a family's solid future, et cetera. We allowed that over the years to get so out of control that we may very well have undermined that dream being available for the average family. Indeed, over the years I supported that idea, I am sure my colleagues supported that idea. In turn, we found ourselves in a circumstance in one neighborhood close to my own a fellow who wanted to live in Oregon, got the bank to provide him with a $600,000 loan.

He and his wife took that to Oregon and walked away from the house, in the neighborhood of which I speak. Next door to that same house another fellow saw an opportunity, because obviously house prices are going to continue going up forever, and he had a home on the marketplace shortly for $2.1 million in a neighborhood where next door it was going to be $600,000. I do not know, have any idea what that bank sold the latter house to two physicians from Loma Linda for, but I am clear, I am absolutely certain they took a heavy loss in connection with that. The fellow who went to Oregon simply walked away.

It seems to me that somewhere we have missed it as we try to make sure the American dream is available to that average family. Now, I read with some interest Treasury's response to all this. And it sounds to me like you may be proposing policies that would take us right back to the track that got us here in the first place. It really seems to me that we ought to be examining whether the family that wants a piece of the American dream should not also have some skin in the game. If people do not put 10 percent down or 20 percent down—it was not that long ago it was 20 percent expected—then they will not have skin in the game. I would like to hear what your thinking is about that as we go forward.

On another level, I would like to ask a question, if I have time, about our governor's suggestion that perhaps Treasury should be involved in helping the California economy with its American dream.

Secretary GEITHNER. Thank you, Congressman. On the housing thing, I think you are actually right that basic failures in underwriting standards, in consumer protection, in lending behavior helped exacerbate the unsustainable boom in housing prices, which has put at peril or put at risk the dreams of many other Americans who are much more responsible in their lives from being able to participate in owning their home, staying in their home. And I think that one of the tragic things about financial crises is when they end, the pain is indiscriminate. It affects people who were careful and responsible, it affects people in neighborhoods who did not borrow too much, did not live beyond their means, had a lot of equity in their house.

And that is what is basically unfair about crises. And that is one of the reasons why it is important that we put in place reforms that will make sure there is going to be more conservative underwriting standards in the future. And that is going to require change to the rules of the game and better enforcement among other things. Now, the proposals in the President's housing initiative I do not believe carry the risk you described. But let me just describe what those are. They have three key parts. The first is working with the Fed to help bring mortgage interest rates down to levels that will help stabilize, reduce the risk of further declines in house prices. And they have come down now to historic lows. Second is to make it possible for millions of Americans, who under previous programs could not refinance their mortgages, to take advantage of them, to have the opportunity to do that. And that you have seen refinancing rates surge. And that program again will be very helpful to a lot of people who would not have had the opportunity to take advantage of lower interest rates. And that will bring meaningful reductions in their monthly payments that will help the economy as a whole as well.

Third piece of the President's program is to allow eligible homeowners to modify their loans to bring down their monthly payments to a more affordable level for a period of time. But those programs will not benefit Americans who really just went too far. They will not benefit speculators or people who bought second homes. So they are carefully designed to have maximum benefit for the people who are most affected by this crisis for reasons beyond their control. And I think they are an important, very important part of recovery. Housing is not the only cause of this crisis, but it is the center of the crisis.

And I think these programs are necessary, and I think will be helpful in those parts of the country that were most affected by the crisis. And very briefly on the question you raised about the ability of state governments and municipal authorities to borrow to finance the programs, meet the basic needs of their communities. Mr. Chairman, can I go on on this?

Mr. SERRANO. Sure.

Secretary GEITHNER. Okay. The municipal market was dramatically affected by the broad pressures this crisis unleashed. And it caused a very, very sharp increase in borrowing costs for governments, for government authorities. And things are getting better, though, on that front. The cost of borrowing has come down a lot. Those markets are starting to find some new balance and equilibrium, and they are significantly better. But there are many States, including your State, where States are facing much higher deficits than they thought, and they are going to face a challenging period ahead still. They are working very hard, as they are in your state, to try to bring those deficits down, take actions that are going to help make it possible for them to meet their borrowing needs.

And we are open to working with the Congress on ways to help address those constraints. A lot of proposals are on the Hill for helping in that context, and we are working with some of the authors of that legislation to see if we can help. But the primary burden is going to rely on governors and mayors to try and make sure that they are taking the steps necessary to bring their deficits down and they can earn back the confidence of the people they need to invest in their securities. We may be able to help in some ways, but they are going to carry the primary burden of trying to manage through this very challenging period.

Mr. LEWIS. Mr. Secretary, you know very well that California, as the Golden State, could go to the marketplace, and indeed——

Secretary GEITHNER. It is actively going now.

Mr. LEWIS. Correct. They can issue bonds, the marketplace will respond.

Secretary GEITHNER. They will.

Mr. LEWIS. They will respond in one way if there is a Federal Government guarantee, Uncle Sam backing those guarantees. And it is hard for me to quite imagine my colleagues from Wisconsin or one of my friends from Kansas want to—it is hard for me to imagine their encouraging Treasury to say, sure, we will back your bonds, and we will pay part of the price, indeed because we know, we are absolutely certain you are going to reduce your spending patterns, and thereby get your economy in order. But it sure leaves a lot of questions in my mind as to whether that is real world.

Secretary GEITHNER. Well, I mean, again, we are prepared to work with Members of Congress who have ideas for how we can help address this. But I just want to point out that a lot of the burden, as all those officials recognize I think, is going to be on them to lay out a path that gets their deficits down to the point where they are going to be able to fund themselves comfortably.

Mr. LEWIS. I will be very interested in your decisions about marketplace versus what might be a new government-backed beginning for a State like California. Thank you.

Secretary GEITHNER. You know, I should say, Congressman, that the Build America bond program that Congress legislated as part of the recovery is a very effective, successful program. It does have the government provide, share some of the burden of borrowing costs of states and municipal authorities, but it is, I think, a well-designed program at a time like this where the country is going through the deepest recession in decades. It is important that States are able to meet their basic needs, that they are able to, you know, keep policemen and firemen, teachers on the job, and they not have to do things that are going to deepen the recession. So I that is good example of things the government has done that can be very effective in this area without raising some of the risks that you alluded to.

Mr. LEWIS. Thank you.

Mr. SERRANO. Thank you, Mr. Lewis. We will now begin to recognize members of the committee under our beloved, but strict 5–minute rule. And we start with the gentleman from California, Mr. Schiff.

Mr. SCHIFF. Mr. Chairman, thank you. I wanted to follow up where my colleague left off. Mr. Secretary, as you know, California has one of the highest unemployment rates in the country. Unemployment in California rose to 11.2 percent in March, the highest level since the State began keeping records in 1976. What is more, the number of people out of work for almost a year rose by 9.4 percent, double the amount in 2008.

A recent budget review by the nonpartisan Legislative Analyst's Office estimated that the California budget—if the budget propositions failed, as they did yesterday, the State will face over a $100 billion deficit over the next five years. A hundred billion dollar deficit. Due to these cash problems, Standard & Poor's lowered its rating on general obligation bonds in February, making California, its bond rating lower than any other State in the country. The short-term municipal bond market conditions are freezing liquidity, sapping investor confidence, shrinking the market for investor municipal issuer bonds, which burden taxpayers with substantial costs and worsen the State's budget woes. These dire financial circumstances have left the State with few options. And the governor is now contemplating just radical cuts in education, health care, and other essential services.

The State estimates it will need to borrow 13 to $15 billion in short-term bonds this year, compared to 3 to 5 billion in a normal year. They will need money in January or face even more severe cuts. It is unlikely the financial markets in the current State could even bear such a large short-term need. And if the State cannot find the money somewhere, it will likely be forced to stop all public work projects, which will have completely counterstimulative impact, cutting critical infrastructure jobs, stop paying its contracts, cut off cash flow to localities that perform State services, could force municipal bankruptcies around the State.

Given the centrality of California in the national economy, and the impact this could have economically for all of us, I am very interested in what you can do. And my sense is, given the enormous flexibility and authority you have already demonstrated, that you probably already have the power even without legislation to help the State of California. The simplest, quickest way to support cash flow borrowings would be a Federal guarantee under TARP or TALF to provide stand-by purchase guarantee to banks, providing credit enhancement for their cash flow borrowings. In the unlikely event that a State or locality could not repay its obligation at maturity, it would draw on the bank line of credit supporting the cash flow, borrowing to repay investors. The Federal Government could then purchase nonperforming assets from the bank under TARP or TALF, and would ultimately be repaid by the State or locality. It presents I think very little risk in the long run to the Federal Government.

On the other hand, allowing California to go belly up presents a great risk to our hoped for continued economic recovery and turnaround. Another solution might be for the Federal Reserve to establish a program to provide liquidity to the short-term municipal bond market by either purchasing variable rate bonds that are sold to banks or loaning banks the money so they can buy municipal variable rate bonds. No solution is perfect. I think the guarantees are the quickest short-term solution, and I think you may have the authority to do that already. And assuming, Mr. Secretary, that you do have the authority to do it, and I understand you may not be prepared to accept my assumption, but assuming that you do, are you willing to exercise it? Because I think the downward drag on the economy that will result if California founders, and we are going to make massive cuts, so it is not like we are asking for a pain free solution, but are you willing to use the authority, if indeed it can be shown that you have it?

Secretary GEITHNER. Congressman, let me just start by saying I think you described the challenges well, and those challenges are not unique to California. They are acute in California, but many States across the country are facing very similar challenges both in terms of level of unemployment, substantial increase in borrowing needs, incredibly difficult choices ahead. And I think you are absolutely right that if States and cities are forced to cut back too much in this context that could deepen the recession and lengthen the point at which—deter and weaken recovery. And that is why the Congress has moved so quickly to put in place very, very substantial support for States. That is why the Build America bond program is so important. And that is why it is so important we get this economy back on track and the financial system working better. And the improvements we have seen in the muni market are partly a reflection of the strength of those broader efforts. But they are not yet back to normal, still a challenging environment.

Now, on your specific question about the authority, let me do this very carefully. We do not believe that TARP, as currently designed and legislated, provides a viable solution to this specific challenge. And let me cite three reasons why that is the case: We are not allowed under TARP to guarantee issues, securities issued after March 2008. We are restricted to giving assistance to financial institutions. The way TARP is designed, every dollar we guarantee is charged against the limited funds Congress authorized. And for those reasons and others, it does not appear to us to provide a viable way of responding to that challenge. And I think that is one reason why your colleagues in the House are considering legislation to address that problem.

And as I said, we are, you know, of course we are prepared to work with Congress on ways to think through how to address this problem, ways that would not make some other problems worse in the future. It is a difficult, complicated balance. We are in very close touch with officials in your State and many other States as they navigate through this. And we are going to keep on watching very carefully. And of course we will work with Members of Congress if they have ways that they think they can mitigate this through legislation.

Mr. SCHIFF. If I could make one last comment, it will be very brief.

Mr. Chairman, I just want to respond to my colleague from California, and your point, which is correct, that there are many other States that are in the same boat, maybe not sinking as fast as California. So there may be broader interests in this idea because of that.

But my concern is, we don't have the time. And we already saw—California already demonstrated—we had to put a halt to all the construction projects in the State. We don't want to do that again. It would run completely counter to what you are trying to do and what we are trying to do with the stimulus.

We will continue to explore with you whether you have the authority already, and if you don't, we will certainly work to give you that ability. But I appreciate any help that you can provide the State.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Before I recognize Mr. Kirk, I want to apologize to Ms. Lee for a little mix-up there. However, just the apology. You don't get any extra time when I recognize you.

Ms. LEE. I know you, Mr. Chairman. You are trying to calm me down and give me time——

Mr. SERRANO. You are going to be angrier now because Mr. Kirk goes first. Mr. Kirk.

Mr. KIRK. I very much appreciate your service to President Bush and to President Obama. And I think that you reappointed Stuart Levy on Iran.

I am concerned that when we have talked to the World Bank, they have refused to tell this committee who the financial intermediaries are between the World Bank and Iran. Over the last calendar year, the World Bank has provided checks from 18th Street in Washington, D.C., to the Central Bank of the Islamic Republic of Iran of $125 million.

I suspect—or previously, the intermediary was Bank Melli then cited by the Treasury Department as a proliferator. I suspect that the intermediary is now the Central Bank of Austria, then paying the Bank of Markaz; and I am wondering if you could commit to us that you would let us know who these intermediaries are that the World Bank is using to pay the Iranians.

Secretary GEITHNER. Congressman, I would be happy to commit to you to come back to you and see if we can be responsive. I can't respond now in that context. I would be happy to have Stuart or his colleagues come up and speak to you.

And thank you for what you said about Mr. Levy. He is an exceptionally capable official, and he has led the design of a remarkably successful program.

Mr. KIRK. Exceptionally capable. And he really has strong bipartisan support up here.

My main concern is about our official borrowing. And I would hope that you would commit to visit Commissioner Van Zandt and the Bureau of Public Debt and the trading floor yourself, because there is a reality check that you will go through once you talk to your team there, since they are responsible for over 40 percent of the funds raised by the United States.

If I look at the charts from the Bureau, you are borrowing—given that so much of your debt is just 4–week debt and rolling over, you are borrowing at a rate of $160 billion a week. So far, since the administration took off, we have borrowed $3.2 billion and we have a new authority that is being used by the Fed in which they are basically printing money and then buying U.S. debt which is now about $126 billion has been used in printed money to purchase U.S. debt.

Now, we have received official concerns from the European Central Bank, from the premier of China and the Chinese central bank on this policy and the growing perception of weakness of the dollar. We have also seen two major industrialized borrowers collapse in their ability to sell debt to the public. The German Government collapsed in an effort in January and the United Kingdom has now failed in two major efforts. Today—and I hope you will take the time to read it—the Wall Street Journal reports that S&P and Fitch have announced that next July, they will strip Britain of its AAA credit rating.

Now, Britain invented what I would call the "guilt standard." When we have some people pressuring European countries to increase their deficit spending, we have a reality check that the markets are already saying to Prime Minister Brown, You are collapsing your ability to raise money.

My question is this: Is the European Central Bank, central bank of China, premier of China, Fitch and S&P all wrong about the concerns about the dollar and the creditworthiness; and you are right, that this is not a completely irresponsible borrowing policy on behalf of United States? Or should we begin to be concerned about a new Treasury debt bubble that is being created under the Obama administration?

Secretary GEITHNER. Congressman, we don't know each other, but I want to say that I welcome your interest and concern about these proposals. And we are going to need your support and the support of the Congress because we are going to face the most challenging fiscal environment in a long period of time. And it will be as critical for this economy, for confidence in our financial markets, for the basic health of recovery, that we work with the Congress to put in place credible commitments to bring our deficits down to a sustainable level over the medium term.

Mr. KIRK. As a Republican moderate, let me say, the message that I am picking up right now from the American people is two messages, one difficult for Republicans to hear and one difficult for Democrats.

The message from the American people that I am getting is, Get out of Iraq and don't raise my taxes. President Bush really didn't want to listen to the first message and President Obama doesn't want to listen to the second. But the message is clear: Leave Iraq and don't raise taxes.

Now, in that environment, which we just heard from the voters in California overwhelmingly, it leads to a downward pressure on spending because the borrowing that you are doing is—the markets are rapidly telling other sovereign borrowers that their plans are not sustainable.

Secretary GEITHNER. Congressman, what I am saying is, you are absolutely right. And as the Secretary of the Treasury, I want you to know that my basic obligation is to make sure that we put in place policies that sustain confidence in this economy, in our currency, that we sustain a strong dollar, we retain what is a great strength and asset of this country, which is the most deep and most liquid markets for Treasury securities in the world.

And we will work very hard to make sure that we bring these deficits down once we put in place a recovery and we fix this crisis that we inherited. Remember, we start with an—we started with an exceptionally high deficit. The cost of the crisis required additional costs up front. There is no way we could solve this crisis without the temporary necessity of higher short-term deficits; and if we did not do this, again we would face higher deficits in the future.

Now, I spent the last 5 years being President of the New York Fed. One of the Fed's responsibilities, as you know, is to help the government fund itself. I am deeply aware of the complexity and importance of that basic task of making sure we are preserving that great asset, which is the most—the deepest liquid markets in the world. And we will work very hard at that.

Now, you are right to say that the Fed has embarked on a very unconventional, exceptional program for buying treasuries.

Mr. KIRK. Which is—basically they are printing money and buying treasuries.

Secretary GEITHNER. I wouldn't think about it that way.

But I think you are right; it deserves an amount of care and reflection and evaluation. But we have a very strong Fed, independent Fed, whose basic obligation to the Congress and the American people is to keep inflation low and stable over time. And they have been exceptionally good at doing that, and they will be good in the future.

And as the chairman has said in public, they are very committed to make sure they have the ability to unwind and reverse the exceptional measures they have taken, once we have achieved the necessary stability in our financial markets and economic priorities are back on track.

Mr. KIRK. I want to close with one technical point, which is this. You were sent a message by the market when the 30-year-note auctions nearly collapsed and you had a large Fed purchase of that and you had to raise the interest rate by 50 basis points to get it sold.

When I was on the trading floor——

Secretary GEITHNER. Congressman, I am sorry. You are right that we are going through a——

Mr. SERRANO. We are running out of time here, folks.

Secretary GEITHNER. That is not an accurate characterization of the events of that day.

Mr. KIRK. But let me just ask this. When I was on the trading floor——

Mr. SERRANO. Your time is up. Can you save that for your second round?

Mr. KIRK. I would have finished in 30 seconds, but——

Secretary GEITHNER. I would be happy, by the way, when we come back in the second round to keep—this is a very important issue, and I would be happy to keep talking about it.

Mr. SERRANO. The Chair is now going to recognize the charming, debonair, charismatic Member from California, Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman. And I accept your apology for jumping over me today. You gave me time to calm down.

Because I am telling you, Mr. Secretary—first of all, I am delighted to see you, glad that you are here; but I am fuming at your response to the chairman with regard to what happened on the medical supply and ag provisions that occurred on Cuba.

First of all, let me just say this: This administration is an administration of change. The President campaigned based on a campaign of change in direction. And we have seen the President mount a major effort, and I fully support what he is doing.

What you said to the chairman in response—with regard to interpreting this provision that was in the law that we passed, consistent with prior interpretations, to me flies in the face of, first of all, what congressional intent was until two Members of the Senate decided it was not congressional intent. And secondly, when you said you want to work with the authorizing committee to try to move forward, how in the world can I accept that? Because the same two Senators may weigh again as we pass whatever changes we may want to pass.

So that is unacceptable to me, because if that is the only reason that you all moved against—violated congressional intent based on what we wanted to do, then I don't know how you are going to do it in the future. That has not changed any interpretation of any laws based on the past 8 years; when we are trying to change those laws, to go back and say you are interpreting it consistent with the last administration, to me, is just downright outrageous.

Secondly, Chairman Rangel and myself, we asked GAO to conduct a report on OFAC and its expenditure of tax dollars as it relates to enforcing the embargo against Cuba. You all were instructed—again, under the last administration, which we never received—to conduct a risk-based assessment, which GAO recommended. Cuba-sanctioned enforcement for many years was unbelievable in terms of the dollars that it took, tax dollars, to enforce. And we believe in GAO in that they have recommended that those resources could be used for efforts to such as protection and homeland security, rather than enforcing and finding individuals who are bringing in Cuban cigars.

Thirdly, Mr. Chairman, let me just ask you about the TARP funding as it relates to minority and women-owned businesses—also minority media outlets. We have written to you and to Vice President Biden. I chair the Congressional Black Caucus, and we have not seen the banks respond at all in terms of advertising dollars. They are not being fair with our tax dollars. And we want to see how the Treasury Department—yourself, Mr. Secretary—can make sure that the banks provide for a level playing field and use some of these TARP dollars, when they are advertising in major media outlets, that they also play fair and provide advertising in black and Latino and Asia Pacific American media.

And we have written to you. We have written to the Vice President. We are going to stay on this until there is some justice in this whole effort. Thank you.

Secretary GEITHNER. Would you like me to respond?

Ms. LEE. Yes, I would.

Secretary GEITHNER. On your first point, I understand your concerns. We are applying the law as we believe it reads. But as I said, we are willing to work with the appropriations and authorizing committees to find a way to move forward in this issue and meet your concerns and the chairman's. I don't know if that is going to be possible, but we would be happy to try.

Ms. LEE. We tried to do that in the legislation.

Secretary GEITHNER. I understand. And I know that I am not addressing your concern today.

Ms. LEE. No. But I mean, we tried to do that is what I am saying.

Secretary GEITHNER. We are going to have to try again, because I think that we don't believe it is—again, we are interpreting the law as we believe it is written.

Ms. LEE. But we were trying to change that as it is written, Mr. Secretary.

Secretary GEITHNER. I understand.

Ms. LEE. So what I am saying to you is that is disingenuous.

Secretary GEITHNER. No. It is not—I will never be disingenuous before you. I am stating exactly why I wrote the letter as I did, what its rationale is for. And I am committing to work with the authorizing appropriators on how to move forward on this question.

We would like to find a way to try to address this, and we have a chance to try and do that.

Ms. LEE. I look forward to working with you on that. I want to see exactly how we are going to do that.

Secretary GEITHNER. That is reasonable. You should judge us by our actions and give me a chance to try and meet your concerns on this issue. I don't know if we can do it, but we will try.

On enforcement resources for OFAC sanctions, for Cuba related sanctions, if I understand the numbers correctly, we have roughly 10 full-time equivalent slots in Treasury now devoted to this enforcement challenge. That is 10 against 155.

I am not completely sure we have got the balance right, but we will keep looking at that and trying to make sure we are not overdoing it and we are not misallocating resources. But we have got a whole set of obligations we have to meet. We have to meet those as carefully as we can and as responsibly as we can.

Your question about minority——

Ms. LEE. The GAO study and the recommendation, the risk-based assessment, are you in the process of conducting it?

Secretary GEITHNER. Of course, as in any case, we look carefully at what the GAO does. And my general view on these things is, of course, how you allocate resources should be guided by a risk-based approach, and we should be looking at where we get the highest return on the marginal resources. That approach is something I believe in deeply.

Ms. LEE. We are looking forward to the report.

Secretary GEITHNER. Now, on the TARP question, I will give you—I hear you. I understand your concern. I understand your interest in this issue. Let me just give you one example where we are trying to be responsive.

We outlined as part of our effort to try to fix the financial system, clean up the financial system, a set of new funds that provide a market for real estate-related loans and securities that were at the heart of the crisis, still gumming up the financial system. And as part of soliciting interest applications for participation by asset managers in these funds, we encouraged firms to partner with small veteran-owned, minority women-owned businesses; and the application—a lot of interest in this program.

I am pleased to say that most applications and certainly the strongest applications have come with very substantial partnerships, and we expect to announce in the next couple of weeks our decisions on the selected asset management companies; I hope you will see in that context evidence that we are trying to be responsive to your concerns in this area.

Ms. LEE. How about minority media?

Secretary GEITHNER. I can't respond to you today on the media question you raised. But I heard you, and I will be happy to get back to you on that question.

Ms. LEE. Thank you, Mr. Chairman. And if we have a second go-round, I have some more.

Mr. SERRANO. Yes. Thank you.

And for the gentlewoman's information, we want to just clarify—and I don't want to drive this subject to death, but the Senate—the House bill had passed full committee. As you know, it was an omnibus bill, so things did not pass the floor.

It passed committee, and spoke to cash-in-advance sales to Cuba. The Senate bill had the same language.

The Senate had an addition to allow businessmen to travel to Cuba. We accepted that. That is part of the negotiating between the two houses, whether you pass a bill on the floor or you do it in an omnibus situation.

It was then that the issue came up of just trying to go around those agreements between Mr. Durbin, myself and Mr. Regula, and the ranking member on the other side. And that is what created the difficulty and the tension.

Mr. Culberson.

Mr. CULBERSON. Thank you, Mr. Chairman.

Secretary Geithner, the question that my colleague, Mr. Kirk, asked is so important, I would like to—if I could, Mr. Chairman—yield a minute to Mr. Kirk to follow up.

Mr. KIRK. I just wanted to follow up on situational awareness of the auctions that you have.

You are selling debt about four times, five times a week now. In general, an auction is between 12:30 and 1:00, with all of the action happening about 6 minutes out from 1:00; and the Bureau of the Public Debt is very proud that they report the results of these auctions within 90 seconds.

Coming out of my reserve duty in the war room of the Pentagon, I said, if you have a collapse of an auction, as now has happened in Germany and the United Kingdom, can you get the President of the United States on the phone right away? Because MSNBC will know before the White House.

And they said, No, we actually don't have that procedure. We would call our assistant secretary who would call the under secretary who might get it.

So I am wondering technically, when you visit the office, can you set up a procedure where Commissioner Van Zandt has your cell phone?

Secretary GEITHNER. Sure.

Mr. KIRK. Because I am very worried as we have now seen other sovereign borrowers begin to collapse, Van Zandt is going to have to get you on the phone as he is telling the media because he has a 90-second reporting requirement.

Secretary GEITHNER. I would expect him to call me and, of course, would ensure that he could

Mr. KIRK. Thank you. Thank you.

Mr. CULBERSON. Thank you, Mr. Chairman. Secretary Geithner, one of the biggest concerns that my constituents have, the people of Texas—I know taxpayers do nationally—is, they consider actually the debt deficit burden faced by the United States is the greatest threat to the Nation. In fact, Peter Heart—the Peter Heart Survey organization just did a survey that the Peterson Foundation released showing that 85 percent of the American public rank as the greatest threat to our national security—ahead of terrorism and everything else, they rank growing budget deficits and the national debt as the greatest threat to the Nation's long-term security. And I absolutely have to agree, when you look at the level of borrowing, the level of spending.

I voted against $2.3 trillion worth of spending under President Bush. I am a dedicated fiscal conservative. I have always described myself as a Jeffersonian, first and foremost, and have so far voted against 1.6 trillion here. So I don't play favorites.

And my concern is—I don't know if you have ever seen one of these. This is a $50 billion bank note from Zimbabwe. It is the real McCoy. Do you have one of these? Do you have one that you carry around? Yeah? Good for you.

Mr. SERRANO. Mr. Secretary, is there a rule about having foreign currency at an appropriation hearing?

Mr. CULBERSON. Thank you. I am glad to see it. Thank you. You obviously are thinking about it a lot, too. I am really thrilled to hear it because that is very important.

And I have, in the brief time that I have got—and I hope there will be a follow-up. I wanted to ask on behalf of my constituents—and I asked them to send me some questions on Facebook and Twitter.

I got a couple of terrific questions, and I want to ask on behalf of several of my constituents—Mark Langford asked this question on Facebook and Robert Gremillion asked the same thing. Mark Langford asked, Mr. Secretary, will you categorically rule out bailing out California or any other States with our tax dollars?

Secretary GEITHNER. I don't know if this is going to be responsive, Congressman. Let me tell you how I always answer that question.

I have a set of important obligations to the American people. The most important of those is to help this President get this economy back on track, repair this mess, put us on a path where we are going to be growing again, and get our fiscal house in order. And everything we do we view through that prism.

And we will have to do exceptional things, as we have done already, to fix this mess, because the only way we are going to get the economy back on track, a more sustainable, balanced recovery to get our fiscal position back to a sustainable level is to fix this crisis.

Now, that is not saying that—that is not putting on the table or taking off the table any specific thing like that. But I just want you to know there are things that we have had to do I never would have contemplated doing and that we are doing it only because we inherited and started with such a traumatically damaging recession.

Mr. CULBERSON. Right. And added to that debt and deficit at a pace that is unprecedented—I know you inherited a lot of debt and deficit, but you have added to it at an unprecedented clip. No Congress has ever spent this much money in this little time in the history of the United States.

Secretary GEITHNER. We haven't had—again, this Congress and this administration started in January with a $1.2 trillion deficit and a deeply damaged financial system and a recovery—a recession that was still deepening and intensifying. And the only responsible way and the only fiscally conservative way to address that challenge was to put in place programs that would help get growth back on track.

And if we did not act, Congressman—and I am a fiscal conservative too. And I think, again, the only responsible fiscal policy this country can adopt is to make sure we are taking actions to fix this crisis. If we did not do that, you would have had much more damage done to the productive capacity of the American economy, to our future revenue base—deficits would be higher in the long term, much greater risk of loss of confidence in this economy.

That doesn't mean we are going to agree exactly on——

Mr. CULBERSON. We obviously have a deep philosophical disagreement.

Secretary GEITHNER. I suspect that we don't, actually.

Mr. CULBERSON. The debt level is just unsustainable, and I think that is where Mr. Kirk was going.

The concern is, we will reach a point—Moody's has already warned us we may lose our AAA bond rating.

Secretary GEITHNER. But, Congressman, understand—I think we disagree less than you think.

You are absolutely right that the fiscal position of the United States is now on a path where, if we do not bring those deficits down, it will be unsustainable. A really important obligation we share—and we can't do it alone; we need the Congress with us on this—is to make sure we have the will to put in place policies that will bring those deficits down credibly to the point where our debt stabilizes at an acceptable level as a share of our economy.

If we don't do that, then recovery will be delayed, it will be weaker and we are going to face much deeper challenges.

Mr. CULBERSON. Without raising taxes and cutting spending?

Secretary GEITHNER. It is going to require bringing our resource expenditures back into balance.

Mr. CULBERSON. Tax increases?

Secretary GEITHNER. It will require us doing what it takes.

Mr. CULBERSON. Is that what you are saying?

Mr. GEITHNER. No. I am going to say it takes what it takes.

Mr. SERRANO. The gentleman's time has expired.

I am not a doctor, but if anybody can help me out, later, Google it, or something, and find out what is the mental condition that only begins a memory recollection from January 20th to now and ignores everything that happened before.

Mr. CULBERSON. I voted against all that spending under Bush. I really did.

Mr. SERRANO. Nobody supported Bush now, it seems.

Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

Mr. Secretary, it is great to be with you again. I think you are probably pretty clear on what I am about to say, and that is, not everybody on the subcommittee agrees that that letter was inappropriate. I, in fact, agreed with your interpretation of the law and thought that your issuing that letter was the correct decision.

I think it is important to note that the fiscal year 2009 appropriations process was done outside of regular order to the dismay of all of us. But the fact that you needed to even issue a letter like that and that we had to go through the process of wrangling with two Senators and going back and forth in a very internal, instead of regular order, way was demonstrative of why your letter became necessary.

So before you go too far out on a limb committing to move in a dramatically new direction on the Cuban policy, with great respect to my colleague on the right and the two on the left—who, I know, do not agree with my views on the matter—please understand that it is very likely, if we tested it, that a majority of the Congress supports leaving the sanctions in place—particularly because have a regime in Cuba that has not reformed, that in spite of President Obama's overtures and the administration's overtures has not made any concessions on human rights, on democracy, on abusing its people, on recognizing political parties.

So let us not go too far out on a limb before we commit to working with the authorizing committees and the appropriators on dramatic change. And in that vein, I want to ask you, because when President Obama made an announcement about the change in policy and relaxed the travel policy for family members traveling to Cuba, as well as rolling back the remittance, the limits on remittances, he also issued a very important statement in sending a message to the Cuban regime that the 30 percent in taxation that comes right off the top of any remittances that are sent to Cuba should end.

Initially, Cuba has—takes—Cuban law takes 20 percent of every dollar that is sent to a relative on the island; that is confiscated by the Castro government. And then they are required to convert U.S. dollars to a convertible—to a CUP, a convertible U.S. peso; and that is an additional 10 percent exchange fee.

What I would like to know is, what steps are you taking to pursue President Obama's urging of the Castro regime to roll back those remittance fees?

Secretary GEITHNER. By the way, just to emphasize how complicated this is, how complicated a question it is, we are working very hard to put in place regulations to apply these new changes in Cuban policy. And as part of that, we would be happy to come talk to you about how to address the separate concern you raised. I don't know really—I can't do it justice now, but it is important.

Ms. WASSERMAN SCHULTZ. It is. Because if the idea is to get the remittances to family members on the island——

Secretary GEITHNER. Of course.

Ms. WASSERMAN SCHULTZ [continuing].—30 percent off the top—which is, by the way, the second largest source of income for the Castro government, second largest source of income—that is absolutely wrong.

And I might add, before any more steps are taken by the administration to ease sanctions, we should at least be insisting on the Castro regime's responding in kind, as Raul Castro strongly indicated everything is on the table. So far, not one thing has been on the table. In fact, reiterated and underscored by the former President, Fidel Castro, that his brother was misguided and incorrect, and nothing has occurred.

So I just wanted to be very, very clear that if we tested it, which one day soon we will, the majority of this Congress does not support rolling back sanctions against Cuba, particularly unless there is a response in kind in easing human rights abuses and making sure that the Cuban people have an opportunity truly to be free.

In my remaining time, I want to ask you a completely separate question related to the visually—the blind and the visually impaired. The American Council of the Blind won a Federal lawsuit against the Treasury, prior to the Obama administration's taking over, about making currency more accessible to the blind and visually impaired. The injunctive relief that was ordered by the court requires Treasury to make changes to paper money; as the currency is redesigned, they will make it accessible to the blind. And I actually had a fourth grader who, when I went and spoke to a class in my district, didn't know about the lawsuit, but raised the issue and said why don't we have Braille on paper money because how are blind people supposed to know what denomination the money is. And I just thought that was the neatest idea and looked into it and found out that this lawsuit occurred.

So can you let us know what progress there is towards making sure that the blind and visually impaired have access to paper money?

Secretary GEITHNER. I can't do justice to that today. I would be happy to come back and give you a more thoughtful response, either in writing or have our staff——

Ms. WASSERMAN SCHULTZ. I would really appreciate that very much, and I will see you on the next round.

Mr. SERRANO. Time has expired.

Just a quick comment. That omnibus bill was not regular order; I agree with you. But it also had a lot of things that members liked and members of this committee asked for that were included. So there are some things we liked, some things we don't like. That is the process.

Secondly, Mr. Secretary, I don't disagree with the gentlewoman that you should ask for things in return. I hope you just do it also with China, Vietnam, Pakistan, Saudi Arabia, on and on, all these countries we deal with that behave in certain ways, not just Cuba for another 50 years.

Mr. Crenshaw.

Mr. CRENSHAW. Thank you, Mr. Chairman. And for the record, I would like to associate myself with the remarks of the gentlewoman from Florida.

Mr. SERRANO. Are you from Florida by any chance?

Mr. CRENSHAW. I am from north Florida.

Mr. Secretary, thank you for being here today. I think you have given new meaning to the term "baptism by fire"—certainly the work that you have done early on here. And I wanted to give you a chance to comment on some good things and some not-so-good things.

You have used just about every tool in your bag to deal with the economy. Rates are as low as they can be for a while. You have spent a lot of money with financial institutions, automobiles; people are asking for money now for the States.

But there are signs, I think—you hear a lot of bright, smart people talking about a potential recovery. You hear words like "rays of hope." I think you said the economy may be "starting to heal."

And I would like you to comment, number one, on what you see as some of those encouraging signs that lead people to begin to say we are seeing the stock market, we are seeing unemployment, we are seeing some positive signs.

But as you comment on that, I would like you to include the area of the average American because you can say, yeah, the big banks are going to the capital markets and raising money, but if the little guy is 70 percent of our economy, is he seeing some of this positive, and how does he fit into this potential recovery?

And on the other side, as you comment on the encouraging, I would like you—on the not-so-good, what are your concerns?

You have been criticized over time, maybe for having an ad hoc approach or piecemeal; but I imagine you have learned a lot of things in a very quick period of time. And so I would like you, after you say some of the—what are the things that you think you have learned? What are the concerns you have?

For instance, if, God forbid, we take a turn for the worse, what are you prepared to do then?

So those two things, if you could just give us your thoughts.

Secretary GEITHNER. Let me do the encouraging signs first.

The economy is showing signs of stabilizing, the rate of decline in growth has slowed, financial markets are starting to heal, it is easier for businesses to borrow in the capital markets, interest rates have come down quite a bit. Costs of credit has come down, the asset-backed securities market is starting to open up again, cost of borrowing by banks has come down a bit. Those are signs of somewhat greater confidence and stability.

But I agree with you that it is very early still; this is really just the beginning. And businesses and families across the country are still going through, again, the most challenging period that this country has seen in decades. The companies are still laying off people. The labor market has not yet stabilized; unemployment is still rising. And even as growth starts to recover—and it will—unemployment is likely to continue to rise for some period of time.

So this is just the beginning. But I—you know, we need to be candid about the encouraging stuff, just as we are candid about the challenges. These are necessary conditions for recovery, and you are not going to get recovery without the financial market functioning better.

And it is important to point out, the positive effect of what the executive branch and the Congress and the Fed have done is to help bring a bit more confidence, lay a bit better foundation for repair of this financial system. And I think that is an important beginning.

But I think you are absolutely right that it is still a very challenging period across the economy, and it is going to stay that for some time because this took a long time to get us into this mess, and it is going to take a while to get us out of it, progress is not going to be even and steady. And I—it is going to feel fragile and uncertain, I think, for a significant period of time.

Now, on the latter question you raised, which is a very complicated question, let me just step back for one second. What I did when we came was to lay out a very broad, general framework of reforms to our financial programs and laid out the specific areas where we thought additional action was going to be necessary—in housing, in getting small business and consumer lending going again, in recapitalizing and cleaning up the banking system. And we have moved at an incredibly rapid pace to put in place very complicated programs within that broad framework. And we are—we made a lot of progress.

We have some programs that are still not operational, but they will be operational in the next couple of months. And I think that basic framework, that basic strategy, is the most effective mix of policies that we believe are available for us to fix this at least cost the taxpayer over time, maximum benefit, to get credit flowing again to small businesses.

Now, people will disagree about whether we got the design exactly right. And we may have to adapt these policies, but it will not be an ad hoc approach. That basic framework, which is to make our banks strong enough that they can lend and fix these broken securities markets is a necessary condition for any recovery in the financial system.

That suite of programs that we put in place are showing important initial signs of positive effect. And what our commitment is, though, is to make sure we are going to do what it takes, and we are going to keep at it until we fix it. Because the cost of us doing too little, being kind of tentative or slow or holding back would, I think, be a deeper recession and more damage to viable businesses, more risk of failure that could have been avoided.

We talked to a very broad range of experts in the financial community and the academic community to make sure we are taking consideration for any good pragmatic idea in this area. But at its core, any effective strategy will be to make sure banks are strong enough to get through a bad recession, they can get lending going again; and we fix these broken securities markets and housing markets.

Mr. CRENSHAW. Thank you.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

We have three votes going on. We have about 5 minutes on this first vote, but a lot of Members are now voting. So we have time to take Mr. Boyd.

And then, after that, we are going to have to take a break, Mr. Secretary. But everybody is eager to speak to you, and you are welcome to stay in an office nearby that will provide for you to look at pictures of my children and things. Undisclosed location.

Mr. Boyd.

Mr. BOYD. Thank you, Mr. Chairman and Mr. Secretary, Mr. Chairman, I want to follow up on an issue that some others have raised, including Chairman Obey and Mr. Culberson, relative to short-term recovery versus long-term fiscal stability.

And I want you, if you would, try to put a little meat on the bone, Mr. Secretary, for us.

Before I do, I want to, for the sake of Mr. Culberson, before he leaves, put us back into historical perspective and go back to 2001 after we had come out of the 1990s, cutting spending and trying to get everything in order. And we had revenues and expenditures as a percentage of GDP both in the 19.5 percent range, with revenues actually being a little bit higher, thereby creating a surplus.

Many of us encouraged the then-new administration to use that money for entitlement reform, tax cuts and debt payment. You know the rest of that story; it was all crammed into tax cuts and even that, you didn't deal with the problems of AMT and estate tax, which even now create a problem where it—it is going to make it very much more difficult for us to come out of this recession because we have to deal with those issues.

Can you talk to me and the committee a little bit about short-term recovery versus long-term fiscal sustainability, and try to put a little meat on the bones about what we have to do to get those numbers back even.

Secretary GEITHNER. You are right about the history. I think it is important to remember that when I left the Treasury in 2001, we had significant budget surpluses in existence and projected. And it is then that we started—this Congress started this year with the largest deficit in decades, $1.2 trillion, a very expensive problem to fix.

I don't believe there is any conflict in the near term between those basic objectives. The only way to get the long-term fiscal position in better shape is to make sure we get growth back on track. That requires—and there is no other way, it requires significant support for demand and it requires again fixing a damaged financial system. And the Recovery Act would not work unless we got the credit flowing again and banks and the capital markets healed.

And—but the opposite was true too. You couldn't fix the economy just by fixing the financial system.

What the President laid out in his first budget was a commitment to bring those deficits down so that 5 years from now, they were at 3 percentage points of GDP. And if sustained at that level, that would leave our debt as a share of GDP at stable and acceptable rates.

If we are unable to do that or convince people, make them feel confident that we are going to do that, then we have the risk that interest rates will be higher, recovery will be choked off, investment will be squeezed out by public borrowing. To achieve that, it is going to require, first, fundamental reform of the health care system so the costs are growing at a much slower pace. That is the most powerful weapon we have to bring this fiscal vision back in order. As you know, it is the President's highest priority; and we believe we are making a lot of progress towards that basic objective.

That is going to be necessary, but not sufficient. We are also going to have to look at a full range of other entitlement programs, including Social Security. And we are going to have to bring about much slower growth in a range of other commitments this government makes.

Mr. BOYD. Mr. Secretary, if I might just follow up briefly, all of the projections under the previous administration after 2001 showed a systemic deficit under the current law relative to revenue and to spending.

You obviously have to change both of those to do what you have just talked about. That is where I would hope you would put a little meat on the bones for us.

Secretary GEITHNER. Again, we have to bring our revenues and our expenditures back into balance, closer to balance; and it is going to require movements in both. And you saw in the President's budget a range of proposals, both on the revenue and expenditure side to help achieve that objective. We laid out paths consistent with that imperative.

And there may be other ways to do it, but I think our obligation is to make sure that the people understand that we have to commit to do that. We have to make sure we do enough to get there and build whatever consensus we can.

And I think what is encouraging, just to find hope in this, is that I think there is broader support now, broader recognition on both sides of the aisle of the magnitude of these challenges. I think that will help provide a basis for a consensus that has alluded us for the last many years.

Mr. BOYD. Thank you, Mr. Chairman. And I just want you to know I am not a Johnny-come-lately fiscal conservative.

Mr. CULBERSON. We are all on the same page.

Will the gentleman yield?

Mr. SERRANO. His time is up.

I am a big spending liberal and proudly so now.

Mr. Secretary, we will break now and we will come back as soon as these votes are over. We appreciate your understanding.

Sorry for the delay, but we had a drawn-out voting process. Democracy gets in the way at times.

The Secretary must leave the hearing at 1:15, so we will try to get in as many of the Members as possible, but certainly the two members who have not participated yet.

And we will start off with Mr. Fattah.

Mr. FATTAH. Thank you, Mr. Chairman.

Mr. Secretary, welcome.

At the beginning of the last President's term, we had hearings like this. We had Alan Greenspan testifying, and the subject matter, if you go back to the transcript, the discussion was the projection that the Bush administration could pay off the entire national debt by the conclusion of that administration, given the surplus and the projected surpluses over time.

And we were literally having a discussion, an academic discussion about whether it would be good for the country to be completely out of debt or whether or not, as the chairman was asked at the time, Chairman Greenspan, whether or not—and he was jousting about maybe leaving some small amount of debt on the books, that it may have some economic utility.

So now we are 8 years later, and it is a very different reality. This administration comes in at a time in which the revenues generated don't meet the country's needs, and we have an economic challenge that you are, in an extraordinary way, trying to address.

And there is good news today from the Philly Fed—I represent Philadelphia, so—in terms of the leading economic indicators report, up 1 percent.

But my question is more about something that is in your testimony, which is this question about tax reform and tax policy. You recommend an increase in the Office for Tax Policy, one that I am very enthusiastic to support. Because I think, at the end of the day, we really have to have a system that generates the needed revenue to protect our national security, to deal with the challenges that our citizens face. And this income tax system we have had for over 100 years I am not sure is what is going to take us over the next 100 years.

The Treasury Department, under Reagan, did some studies of fundamental tax reform, found the notion of a flat tax fundamentally flawed, I think in the words of the report, and that a national sales tax wouldn't work.

The Bush administration, without a lot of publicity, did—the Treasury Department for Bush did two studies on the same two ideas and found them not to be workable.

I am interested in whether or not this Office of Tax Policy is going to look at fundamental reform. Because I am supportive of the notion that we need to have a system that is reliable so that we don't have, as much as the President and you talk about this bust-to-boom economy, that we don't have in our national budgeting and governmental responsibilities a system that can't generate the revenues the country needs at any particular time, whether it is in face of war or in face of a need for economic stimulus, and that we don't have to have a circumstance in which we are using a system of generating revenues that may have outlived its usefulness.

So I would be interested in your comments about fundamental reform and this Office of Tax Policy and where your thinking may be on the subject.

Secretary GEITHNER. Thank you, Congressman.

I think I would define the hierarchy of priorities this way: We need to do a much better job of enforcing the existing tax laws we all live with. And you see in the budget substantial additional resources for the IRS into enforcement activities, which we think will generate substantial revenue. That is fair, it is important to do, and that is where we start.

The second thing I would say is that, across the entire economic policies of the President that we are working towards, there are very important tax provisions that we will have to confront. Health care is a good example. And, in that context, we are going to have to look for ways to make sure that, as we work to bring down costs and reform this health care system, that we are finding revenues to pay for the commitments we all think we need to make.

We also believe that there is going to be a substantial opportunity to simplify the Tax Code. The President made some very important proposals in his campaign to begin that process. And we will begin to examine ways we can simplify this very complicated Tax Code we have.

Looking beyond that, we hope and expect we will have the opportunity to look at a broad range of other aspects of the Tax Code. In the corporate tax area, there is a lot of opportunity for reform that would help make U.S. business more competitive and close some gaps and loopholes, make that whole system more fair too.

So that would be an initial list of priorities.

The Office of Tax Policy is one of the great resources of the Treasury and the country. And we are proposing some significant additional resources so that they can discharge what is a much, much more demanding burden than I think their predecessors had. And we would welcome the support of this committee and the Congress for that objective.

Mr. FATTAH. Well, let me just say, you are going to have my support and, I believe, the committee's support. You now have 44 economists and some 30 lawyers there that you will take on and making a significant investment there.

I am interested in something you didn't list in that outline you listed, which is looking at fundamental reform, new ideas that may have utility, you know, in terms of improving the economic capacity, job-creating capacity, and not just making what we have now work a little bit better, which is in everyone's interests, but looking at whether or not what we have meets the needs of the country going forward and whether there are some other ideas that should be reviewed by your Tax Policy Office.

Secretary GEITHNER. Yeah, I just wanted to start with the initial list of priorities, but, as you know, in the Recovery Act in the President's budget there is a very long list of important provisions that are designed not just to make the Tax Code more fair and more balanced, but to make sure we are putting in place incentives to encourage savings and investment over the longer term.

And, absolutely, as any Secretary of the Treasury would, we are always looking at broader opportunities for reform in the Tax Code. And we may have the opportunity in this Congress, this administration, to go beyond that initial list of priorities I laid out.

Mr. FATTAH. Well, thank you very much, Mr. Secretary.

Mr. SERRANO. Mr. Edwards.

Mr. EDWARDS. Thank you, Mr. Chairman.

Mr. Secretary, there is still a lot of frustration and anger among everyday citizens and families regarding TARP 1 and TARP 2. The sense persists that, why should my hardworking tax dollars go to bail out people and corporations that made terribly irresponsible decisions? Why should that happen?

So I would like to ask you two questions. In your opinion, what would have been the possible negative consequences to our economy if TARP 1 and TARP 2 had not been approved? And, secondly, what could have been the specific impacts upon average working families if AIG had not been given Federal funding?

Secretary GEITHNER. Congressman, let me try to respond to that very important question.

I believe that what the Congress authorized at that time, in September, was absolutely necessary to prevent the catastrophic failure of the U.S. financial system. And without that authority and without those actions to put capital in banks, we would have risked seeing much greater failure and much more damage to pension values, to cost of credit, much larger business failures, higher rates of growth in unemployment even than we saw.

This recession was going to be a challenging recession no matter what, because it followed a long period of over-borrowing, overleveraging. We were living beyond our means as a country; many

Americans were as well. So it was going to be a difficult recession. But it was made dramatically worse because this country came into the crisis without the tools to limit the damage to Main Street from some of those excesses.

So I would just say, the starkest way to say it is, people saw a version of this in the last few months of last year, where you saw the economy decline at a remarkably rapid rate, here and around the world. You saw pension values decline dramatically; Americans are going to have to work longer because of this. You saw interest rates rise dramatically, businesses fail who didn't need to fail, because of damage to the financial system. And that was even with dramatic action. If that authority had not been provided by the Congress, those actions not taken, it would have been dramatically worse.

Now, important difference between TARP 1 and TARP 2. So, when I came into office, the President came into office, we made some very, very important changes in priorities and direction in response to the legitimate frustration and concern people had about how that program had been administered.

So we put in place much higher standards for transparency. So all the detailed conditions, terms that were provided to banks across the country were put on the Web site. People could see who was getting assistance across the country.

We put in place much more stringent reporting requirements so people could see where lending was rising, how people were using that money. We put in place stronger conditions on compensation, on dividends, so that the money was going to benefit lending.

But, as important as that, we redirected the whole program, so we were directly focusing on fixing the housing crisis, getting small banks capital, getting small business and consumer credit going again. And those are the things we have done.

Now, we had to take some additional action to help stabilize AIG, help stabilize Fannie and Freddie. Those are complicated problems we inherited. And, without action to do that, then, again, you would have faced the risk that you would have another wave of collapse in confidence that people see in their monthly savings when they open up those pension accounts, and you would have seen much greater damage to capacity of businesses to borrow, higher rates of growth and unemployment. And that is the starkest way to present it.

But I am not sure people are aware of this. The only assistance that we have provided since this President and this Secretary came into office to banks is for banks—under the program my predecessors put in place, the only additional assistance was to small community banks across the country and, of course, to help stabilize AIG. What we have tried to do is to try to make sure that the major banks are going into the markets to raise capital and are restructuring so they need to do that.

So these are big changes in the direction of the program, and I think they are helping, as we have discussed earlier, helping to bring some measure of healing and stability to the financial system. And you see that reflected in somewhat greater confidence numbers.

Mr. EDWARDS. Could you just very briefly address the AIG issue? To talk to an individual family, what could this have meant to them? Would they have lost their life insurance value? Would they have lost their pension? Why should the Jones and Serrano families care about AIG going under?

Secretary GEITHNER. Well, there is a direct risk to people across the country who bought insurance products from AIG——

Mr. EDWARDS. By "direct risk"—and I want to put this in everyday terms. A "direct risk" doesn't mean something to the everyday person. Does that mean they paid in for 20 years into life insurance or a pension and they were going to lose that pension or a big part of it?

Secretary GEITHNER. Well, there is some risk of that, but, you know, people bought a whole range of products from AIG. They bought protection that guaranteed savings values. Those could have been at risk.

But it is bigger than that. It is not just that direct risk, which could have been significant. Again, the greater risk is that you would have had broader loss of confidence, greater failures to other businesses, other financial institutions, that would have produced, again, this dynamic we saw in the fall of higher unemployment, more businesses failing, pension values hurt by the fallen equity prices, credit not available.

So it is not just the direct, immediate consequences people can see; it is the more indirect consequences that people sort of lived with in the last half of last year.

Mr. EDWARDS. Okay. I will finish by saying I think we need to make a better effort, all of us, Members of Congress included, that supported TARP 1 and 2, to explain in everyday terms in a way that the average person who is not into Wall Street finance can understand the consequences had we not had TARP 1, TARP 2, had AIG gone under and Citibank gone under.

Thank you, Mr. Secretary.

And thank you, Mr. Chairman.

Secretary GEITHNER. I agree with you, Congressman. You said it well.

Mr. SERRANO. Thank you.

As we stated before, the Secretary has to leave at 1:15, so we are going to try to get as many more questions as possible.

Mr. Secretary, this week it was reported that Goldman Sachs and Morgan Stanley have asked to repay $20 billion in TARP payments. Press reports have indicated that they are eager to remove themselves from the Federal restrictions that were attached to the use of these funds.

What criteria will you be using to determine whether these large financial institutions will be allowed to repay this money or get out? Does your criteria go beyond the ability to repay? Does repayment by large institutions create a disincentive to invest in or work for institutions that have not yet repaid the funds?

In addition, when the TARP was created, all the financial firms were at risk. Congress insisted that, when TARP funds were provided, the taxpayer gets some upside benefit in required stock warrants. If some financial institutions repay their TARP money, what will you do to make sure the taxpayer gets full benefit from those warrants?

Secretary GEITHNER. Mr. Chairman, under the law, as modified in the Recovery Act, the judgment about whether firms can repay is a judgment left with the Federal banking agency that is responsible. I would be happy to describe what I believe the policy will be, but I want to emphasize that it is their responsibility to approve these repayments.

The two basic conditions are, to say them simply, that you need to have more capital than the Fed's recent capital assessment said you needed, you need to have that additional capital. And you need to demonstrate that you can issue debt in the markets without an FDIC guarantee. That is sort of an additional protection to make sure these banks are not taking advantage of other programs the government has laid out to help stabilize the system as a whole.

If they meet those two conditions, then my expectation is that they will get approval to repay. And that is a positive sign about how far the system has come to a greater foundation of stability.

Now, on the warrants, the way it works now is firms have the ability to come and repurchase. And if they do that, we have an elaborate process in place to try to make sure we use outside, market-based pricing to judge the appropriate value to the taxpayer in that context.

If they don't want to repurchase, we still have the right to sell those warrants into the market. And we would use an auction procedure, if we do that, to make sure, again, we are getting the best price for the taxpayer. We have to make a careful judgment about what the right time frame in which to dispose of those warrants, and that is something we are thinking through carefully now.

Mr. SERRANO. Well, I hope that that becomes something that we pay a lot of attention to. As Mr. Edwards stated, there is still—and you can't get a single Member of the House or the Senate, 535, that have not heard from a group of people saying, "Who is bailing me out?"

So, we did this. Now we have to make sure that we get back what is ours. And we have to make sure that people don't squirm out of it and get away with what they shouldn't be getting away with.

Secretary GEITHNER. Oh, absolutely.

And remember, you know, these initial indications that a number of major institutions will be able to repay will allow the American taxpayer to see that there is money coming back that the government earned a return on.

And I am not sure this is exactly the right number, so give me a chance to adjust this, correct it for the record. But the number of payments already that have come into the Treasury from those capital investments made in the fall, I think, now exceed $2.5 billion already. So that is resources back into the government, back in the taxpayers' hands, reflecting a return on that initial investment.

Mr. SERRANO. Okay, I just have one—I am going to put the rest of my questions in for the record. Your testimony discusses scrapping the early EITC program because of problems with fraud. But that program is of value to low-income, working families.

The last administration made a big deal out of fraud in the EITC. And when I say "big deal," they made it sound like the program was horrible and it was the only program in the country that had a problem. But it was not committed to making the EITC program work well.

No one can defend fraud. But before you scrap the program, are you sure that you cannot eliminate the fraud so that the program can continue? And can't the program be promoted for wider usage?

Secretary GEITHNER. Mr. Chairman, this is a very important program, a remarkably successful program. And this President and I certainly am committed to making sure that a broader EITC program is sustained and working and doing what it is supposed to do.

This particular part of that program, though, has been troubled in implementation. And our judgment is that we need to modify this program the way we have proposed to eliminate that risk, and we think its impact will be modest.

The vast bulk of this existing EITC program will remain in place and will continue to do what it needs to do. But, of course, we will reflect on your suggestion and concern, and, of course, share your commitment to making sure we are eliminating any opportunities for fraud in this program. And we will do it without causing too much damage to the other broader objectives of the program.

Mr. SERRANO. Right. And I think the key word here is modify, not eliminate.

Like I said, I will submit the rest of my questions, in a desire to give everybody at least one crack before you leave at 1:15.

Mrs. Emerson.

Mrs. EMERSON. I would like to submit questions for the record, as well.

Mr. SERRANO. Without objection.

Mrs. EMERSON. One very, very quick, quick AIG question, and then I have another one to ask you.

As Chet was saying, and Joe, too, to a certain extent, I mean, our constituents were up in arms about the whole AIG thing. And one of the other problems—and I am not quite sure how to explain this; perhaps it was a process thing—would there have been any way for you all at Treasury to have said to AIG, "Okay, we are going to give you X amount of dollars; however, you can't use some of that money to then pay your counterparties like Societe Generale and any of those"? That would not have been possible?

Secretary GEITHNER. No. Again, we came into this crisis without the tools and authority to manage, prevent the potential failure of a large institution like this that could cause a lot of damage to the financial system. And, without that authority, we had limited options.

And when you choose to act to prevent failure and defaults, you are making a choice to help make it possible for that firm to meet all its commitments to people who brought an insurance product from it, of any sort. And you can't selectively allow the institution to default on particular types of creditors without risk that the whole thing comes unwound, comes crashing down at risk of great damage.

And, again, the American people lived with, the last few months of last year, the consequences of failure of large institutions. A big part of what made the recession so deep and so damaging in this country was the damage caused by the default and failure of other significant institutions. That would have been much worse if AIG also had gone.

But the short answer to your question is, no, not possible without greater authority. And that is why we are working with the Congress to put in place resolution authority to give us a little bit more flexibility in handling these things more early, more quickly, and more effectively.

Mrs. EMERSON. I appreciate that. Thanks.

The special inspector general for the TARP has stated in written testimony, basically he says, quote, "We stand on the precipice of the largest infusion of government funds over the shortest period of time." And then, just to save time, "We are looking at the potential exposure of hundreds of billions of dollars in taxpayer money lost to fraud."

So, my question is, number one, how closely are you all working with the special IG for the TARP, GAO and others, in the formulation of your TARP programs to prevent this vulnerability to fraud?

And I am assuming that you are doing everything possible to ensure that the IG has full cooperation from you all, but are you also detailing staff? Because I know that they were very short-staffed when I met with him earlier.

Secretary GEITHNER. We are working very closely with him. And I want you to understand, it is exceptionally important to me that we do everything we can to reduce the risk of fraud in any of these programs.

I think, as you said, the confidence of the American people that we are using the taxpayers' money as wisely and as carefully as possible is deeply important to the overall effectiveness of our programs. Part of that is about making sure we are reducing risk of fraud.

We are working very closely with the SIG-TARP, with the GAO, with the congressional oversight panel. I think my second day in office, I met with them as a group. We look at all of their recommendations, and we will make sure they resources and access necessary to do their jobs. And where they have suggestions and ideas that we think work, we will take them on board. And I found their recommendations, in general, very valuable.

Mrs. EMERSON. Do you have any way of trying to determine how much of the TARP funding could be lost to waste or fraud, or is that something that kind of has to come back after the fact?

Secretary GEITHNER. Well, we are going to reduce the risk to the extent we can. My own sense is—but, again, this is something we have to keep looking at—that the programs that we inherited were actually quite carefully designed to limit that risk. And I am sure that the programs we put in place since I came into office will be very well-designed to help limit that risk.

It won't be perfect. You know, these are substantially complex programs with substantial resources in place. But we have put a lot of protections in place at the front end, and we have the great virtue of having SIG-TARP and GAO and the congressional oversight panel looking at everything we do.

And one of the greatest protections we have is to make sure that there is transparency across all of these programs. That allows everyone to see what the terms are, where the resources are going to, and that is a good protection too.

Mrs. EMERSON. All right. Thank you.

Mr. SERRANO. Thank you.

Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

Good afternoon again, Mr. Secretary.

Let me go back again to my colleague from Florida, who is a good friend of mine, who I respect tremendously, and who knows I am discussing this with you, because we discussed this as we walked down.

First of all, with regard to any possible movement on legislation as it relates to Cuba moving through the House, I just have to remind you that over 70 percent of the American public wants the embargo ended. Over 60 percent of the Cuban-American community wants the embargo ended. Okay? So that should tell you something about public opinion and about the possibilities of any actions that we may take here on the House side and on the Senate side.

Secondly, let me just say, she mentioned the issue of remittance. I wanted to clarify this, because the percentage of remittances is 20 percent, and then there is a 10 percent surcharge, FYI and for the record. And my colleague from Florida understands that also.

And I would suggest to you to look, as you have these talks, if you are, with the Cuban Government, understand that some of us believe that taxes on income is appropriate. The more income we make, the more we are taxed. Now, the structure and the tax fairness of the issue has to be addressed. Now, whether that is consistent with Cuban policies as it relates to taxes, who knows. But, for the record, most countries charge a tax on additional income.

Secretary GEITHNER. Including this country.

Ms. LEE. Including our own country. And so I think we have to be fair as we approach any types of discussion on remittances and have to know what we are dealing with.

Secondly, let me just go back to the issue of the involvement of the banks. And I asked you this earlier, and I want to pursue it with you a little bit, because we want the CEOs of the banks that receive TARP money to tell us how much money they are investing in minority-owned newspapers and media outlets. I want to see those numbers, I want to see what they are doing.

And then we need to talk about a strategy to commend them for their approach and the dollar amount and the percentages, or tell them they are going to have to do better. So we need the numbers, though, first, Mr. Secretary. And that is what we have communicated to yourself via letter and also to Vice President Biden.

Secretary GEITHNER. I will take a careful look at that.

Ms. LEE. Okay. I would appreciate that. And members, I know, of the Congressional Black Caucus would appreciate that.

And thirdly and finally, Congressman Waters, in our economic recovery efforts, has been really looking at minority hiring at the Treasury. And we have passed—and this was Congressman

Waters's effort, and she actually worked to create an office of minority affairs within the GSEs. The Federal Reserve, Chairman Bernanke, is looking at that model also. We are not sure if he needs legislation or not.

But we wanted to know if you would consider, or are you considering, any efforts within Treasury to establish an office of minority affairs or something similar to what the GSEs are doing? And we would like some information on your minority hiring, in terms of the diversity of your staff and also the contracting out of your office.

Secretary GEITHNER. I would be happy to give you any information on hiring and on contracting. And I have not considered it before, but I will consider, as the GSEs and the Fed are considering, your suggestion on an office. As any suggestion, I will consider carefully that suggestion.

Ms. LEE. Thank you very much.

And thank you, Mr. Chairman, for giving us the time for a second go-around, because we are going to consider to pursue these issues.

Mr. SERRANO. And we are getting down to that time.

Mr. Fattah.

Mr. FATTAH. Mr. Secretary, you have said that the revised RFP, in terms of the packaging, was getting ready—I know the deadline was originally April 10th. It was then moved back, right? So it is getting ready to happen soon.

Secretary GEITHNER. You are talking about for our investment funds? Our public-private investment program?

Mr. FATTAH. Yes, correct.

Secretary GEITHNER. Actually, I think the initial deadline was—well, we put out the request for applications, and I think our initial expectation is we would announce appointees in mid-May. We have pushed back for a couple weeks that announcement. But we are now in the process of going through the strongest applicants, the more detailed due diligence on their applications. But we are close to announcing.

Mr. FATTAH. And one last point, which is not a point of controversy with me, but I do want to raise it nonetheless since it has some currency.

TARP, as you receive either earnings on those investments or repayment, your intention is to have those dollars available in case there are other needed interventions as we go through this process of trying to get the economy back on track, is that correct?

Secretary GEITHNER. Well, just to clarify, the way the law is written, a dollar of repayment comes back, goes into the general fund to reduce the debt, but it creates a dollar of authority we can use to make new investments if we think there is a strong case for doing that, under the terms of the act.

For income, the dividend coupons on the preferred stock, I believe those go directly into the general fund. I don't think we can use those. But that is something I have to clarify.

Mr. FATTAH. Thank you very much.

Mr. SERRANO. Mr. Secretary, before we end, I just want to let you in on something. If you were to attend the Democratic caucus meetings, you would see that every time our leadership comes up with a program that they are presenting to us, a new law, possible new law, I get up and I ask, "will the territories be included equally?" And it is happening more and more every day.

Your predecessor participated in doing something that had never been done before, and it had the support of Leader Boehner, at the insistence of our Speaker, as I presented it to her, and that was that, regarding the stimulus checks that were sent to 50 States, the territories were included. And the issue of whether or not they pay certain taxes or not—which, you know, that is all a fallacy; they do pay taxes—was not an issue, because it is the same economy. You send a check to Puerto Rico, where do they spend it? At Sears, at K-Mart, Circuit City when they were in existence. It is the same places—McDonald's, whatever.

So it is important for many of us that, as you look at your policies in the future, that we remember that it is not just 50 States, it is also people who live under the American flag and American citizens and American nationals. And we include them in everything else. As we speak, you know, there are hundreds, if not thousands of them, thousands of them in Iraq and Afghanistan. We should include them at other times, too.

Secretary GEITHNER. Mr. Chairman, I just wanted—I agree with you. And when I was president of the New York Fed, which I was for 5 years, I had the privilege of having as part of my district Puerto Rico, and agree very much with what you said.

Mr. SERRANO. Yes. And, you know, that is a little inside joke in the Puerto Rican community, which is, some years ago, when the Puerto Ricans were the lead group, Latino group, in New York, someone decided at the Federal level, whatever the New York region was, it included the Virgin Islands and Puerto Rico. And so the director of the New York region for HUD, for FDA, whatever, got to travel to Puerto Rico and the Virgin Islands as well as Manhattan.

Secretary GEITHNER. Just for the record, I did travel to Puerto Rico but not to the Virgin Islands, even though the Virgin Islands was also part of the New York Fed's district.

Mr. SERRANO. Well, we are going to take care of that now.

So we thank you. And we want you to keep these things in mind. As you can see from the questioning, this committee is very much interested in the work you are doing. We are all on the same side in bringing back our economy and taking care of the American people and making sure that the taxpayers don't get ripped off as we take care of other people. So we stand ready to work with you.

Our opening comments on Cuba—and you heard many other comments on Cuba—only mean that we have to keep in touch. And isn't it interesting or ironic that, 52 years later, Fidel Castro is still an issue in the U.S. Congress? It is amazing. You are gone from this place a month and they don't remember you, and he is still an issue 52 years later.

We thank you, sir.

Secretary GEITHNER. Thanks for having me. I appreciate your support, and we will work very closely together.

Mr. SERRANO. Thank you.

The meeting is adjourned.

HOUSE APPROPRIATIONS SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT QUESTIONS FOR THE RECORD

United States House of Representatives

Hearing on the Treasury Department

Treasury Secretary Timothy F. Geithner

May 21, 2009

Questions from Chairman Jose E. Serrano:

1. **One of the major innovations in the use of TARP funds by the Obama Administration has been to set aside up to $50 billion to provide mortgage relief. Although the mortgage crisis hit New York a little later than the rest of the country, it is hitting us hard now. Minority communities are being hit worst. In many cases, minorities who qualified for a conventional mortgage were given subprime loans. The mortgage broker made a higher commission, but the homeowner was stuck with a mortgage that adjusted to a higher interest rate than they could afford.**

   Unfortunately, many banks do not seem inclined to renegotiate mortgages, whether they still hold the mortgages or they service them for investors in mortgage securities.

   Meanwhile, more and more people are falling behind on their payments and losing hope of negotiating a way to stay in their homes.

   What does Treasury plan to do to expedite renegotiation of mortgages? How much relief can homeowners expect? How soon can we see that relief?

   The Making Home Affordable (MHA) program was announced in broad terms on March 4th. Given this fact, we are off to a strong start. Although it is still early – MHA's detailed guidelines were released only about five months ago and the first Servicer Participation Agreement was signed about four months ago – there are already clear signs that the incentives offered under MHA are having a substantial effect. Participating servicers have extended offers on over 570,000 trial modifications and 360,000 trial modifications are underway.

   Participating servicers' contracts require them to screen all potentially eligible borrowers for financial hardship. Then servicers are required to run a Net Present Value (NPV) test on all loans that meet the program's eligibility criteria, and to offer a modification if the NPV test produces a positive result. Borrowers receiving modifications can expect to have their monthly payments reduced to 31 percent of their gross monthly income – a sustainably affordable level – with that payment locked in for five years, and the interest rate on the loan capped at the Freddie Mac Survey Rate for the life of the loan.

   While the Home Affordable Modification Program (HAMP) is already providing relief to struggling Americans, participating servicers' ability to expand their capacity and execute efficiently will be critical to the long term success of the HAMP. The program's success-based payments are designed to provide servicers with the financial incentive to scale up their operations quickly, as payments are only made once trial modifications are successfully completed. Servicers are already responding to these incentives by adding staff in significant numbers to support call centers, populating easily accessible information online and sending hundreds of thousands of mailings to borrowers who may be eligible for the program.

However, it is clear that more must be done. To this end, Treasury has begun planning a series of senior-level meetings at which Treasury and HUD staff will meet with top executives of participating servicers to discuss the steps they have already taken to implement the program and their specific plans for expanding capacity going forward. We have asked each participating servicer to appoint a senior liaison as the dedicated contact person for program implementation within their organization. In addition, we have instituted loan level data reporting, allowing us to gain a fuller understanding of areas where participating servicers are underperforming. In August, we published program data on a servicer-by-servicer basis, providing additional incentive for servicers to ramp up operations and improve their results. Treasury has challenged servicers to meet a goal of 500,000 loan modifications by November 1.

2. **As with the single family housing crisis, where we know that the Department is hard at work identifying solutions, we have identified a similar crisis in the multi-family residential housing market. In New York City, and we suspect in other high market cities across the country, we are now dealing with an overwhelming crisis caused by irresponsible lending and speculative investment in affordable rental housing. Many of the affected properties were specifically targeted because speculators saw them as "undervalued" or "underperforming" assets due to existing rent protections or subsidies that kept units affordable. Investors overpaid for these assets, saddling many of the buildings with mortgage burdens that are totally unsupportable. Low- and moderate-income families who live in these buildings are now facing tremendous pressure from landlords who need to terminate rent protections, displace existing families, and seek higher rent-paying tenants. Families in these buildings are also seeing massive disinvestment in their housing as owners have to choose between paying their inflated mortgage payments or keeping the buildings running properly. In all cases, working families across the city are losing out and there is widespread fear of the potential for massive displacement.**

   While I in no way encourage financial support or relief for speculators and irresponsible lenders, I would strongly urge the administration to find a way to intervene on behalf of innocent tenants, most of whom are low- and moderate-income and especially vulnerable to the current economic climate. Is your department willing to consider using TARP funds, or other federal resources, to ensure that lenders act in such a way to protect tenants and affordable housing as this second-wave housing crisis unravels, including possibly working with banks and other lending institutions to ensure that these overleveraged buildings are put back on the path of financial viability?

We recognize the important role that the multi-family residential housing market plays in providing affordable housing opportunities for renters. Treasury has already taken significant steps to support the multi-family market by strengthening confidence in Fannie Mae and Freddie Mac, which together represent the largest source of financing for multi-family housing. However, we are also considering additional options to help support this very important part of the real estate market. For example, Treasury is exploring ways to support state and local housing finance agencies (HFAs). In addition to providing low-rate mortgages with down payment assistance to low- and moderate-income borrowers, HFAs also develop affordable multi-family housing and provide debt financing to developers of such housing. We agree that this is an important issue and we will continue to carefully monitor developments in the multi-family housing market.

3. **One subject in which this subcommittee has taken a strong interest is the number of families in low-income communities who lack bank accounts, and how best to expand the availability of low-cost financial services. The IRS Taxpayer Advocate has recently reiterated her concern about the prevalence of high interest-rate Refund Anticipation Loans, and thus the need to speed up the issuance of refunds to taxpayers, especially EITC refunds. The Taxpayer Advocate has recommended that the Treasury Department and the IRS develop a stored value card program as a way to distribute tax refunds to taxpayers who lack bank accounts, similar to the Financial Management Service's Direct Express Program for distributing Social Security benefits. What are the Department's views on this approach? Does the Department plan to implement a stored value card program for tax refunds, as recommended by the Taxpayer Advocate?**

The Department of the Treasury shares the subcommittee's strong interest in making low-cost financial services available to low-income families. The Department is reviewing various mechanisms by which to furnish tax refunds, and in the process of doing so, to make various financial services available at no or low cost. In addition to considering stored value card programs, the Department has been considering the possibility of facilitating the use of direct deposit of refunds to purchase U.S. savings bonds. Also, the Treasury and IRS have worked on developing the capacity to allow taxpayers to direct the IRS to make direct deposits of a tax refund to more than one account ("refund splitting"). For example, part of a refund could be deposited into a savings account, including an IRA, or to purchase a US savings bond, and the remainder into a checking account. Further, the Treasury and IRS are exploring alternatives regarding tax refunds for people who need to be brought into the banking system. We look forward to discussing this issue with the subcommittee as our plans in this area evolve. Meanwhile, the IRS runs a number of relevant programs, including partnerships with banks that agree to offer low-cost bank accounts at volunteer tax preparation sites.

4. **When the TARP was sold to Congress, we were told that a credit crisis was shrinking the economy and the TARP would create more lending.**

   The Wall Street Journal recently analyzed the extent of new credit extended by 19 big banks who received TARP funds. The Journal found that, outside of mortgage refinancings, the big banks had cut consumer lending by a third and business lending by 40 percent.

   The public has the impression that TARP money has gone to the banks with no accountability, that hundreds of billions of dollars went out the door with only a wish and a prayer that banks would lend more.

   What is the Department doing to ensure that TARP funds are actually creating more credit for American families and businesses?

   Treasury always seeks to ensure accountability for TARP funds and includes appropriate measures in each of its programs to ensure such accountability. Reporting requirements necessarily differ depending on the use of funds or the program at issue. TARP programs can be divided for this purpose into two types: programs that are designed to bolster the capital of an institution and programs designed to provide targeted financing on a case-by-case basis. The Capital Purchase Program (CPP), which represents over $200 billion of TARP funds invested by Treasury into viable institutions of all sizes, is an example of the first type of program. The terms of the CPP do not require an institution to engage in a particular level of lending. Such mandates would be inconsistent with the nature of our financial system and would not further the basic objective of the EESA, which is to promote financial stability.

   The CPP provides capital to banks helping to ensure financial stability of the system as a whole and enabling banks to continue to lend to creditworthy borrowers during these types of crises. In terms of diminished lending, numerous economic research studies have documented that lending to both consumers and businesses contracts during recessions is due to the decreased demand by borrowers as well as the tightening credit standards of lenders. Without Treasury's efforts to stabilize the financial system, consumer and business lending levels would be even lower than they are today.

   In order to help assess the impact of this program on lending, Treasury requires reporting by banks on general lending and intermediation activities using Treasury's Monthly Lending and Intermediation Survey and Snapshot and Treasury's Lending Report. The Monthly Lending and Intermediation Survey and Snapshot measures the lending and intermediation activities of the 21 largest banks participating in the CPP which helps the public easily assess activities of these banks. The Snapshot contains quantitative information on three major categories of lending – consumer, commercial, and other activities – based on banks' internal reporting, as well as commentary to explain changes in lending levels for each category. The CPP Lending Report, also published monthly by Treasury, reports on the monthly average outstanding balances of consumer loans, commercial loans, and total loans from all CPP participants.

5. **Executive pay in the financial services industry has risen much more rapidly than pay in the rest of the economy. Bad decisions by this sector have driven the economy off a cliff, but its defenders still claim that its wise decisions deserve tens of billions in bonuses.**

   Earlier this year we learned that Merrill Lynch lost $27 billion last year. It received billions in TARP money, yet it turned around and paid $4 billion in bonuses for last year. As a result of those big bonuses, almost 700 people made more than $1 million at Merrill Lynch last year.

   Does the Department agree that there is a problem with excessive executive pay in the financial sector? Just how hard-up for cash are these firms, if they are still able to pay huge executive compensation packages? What can be done about it?

   To operate efficiently and safely, our financial system requires rules and practices that encourage sound risk management and align the benefits for market participants with long-term growth and value creation – not only at individual firms, but for our financial system and the economy as a whole.

   Executive compensation practices were one of several factors contributing to the current financial crisis. Incentives for short-term gains overwhelmed the checks and balances meant to mitigate the risk of excess leverage.

   In considering reforms, we start with a set of broad-based principles that we expect to evolve over time. By outlining these principles, we begin the process of bringing compensation practices more tightly in line with the interests of shareholders and reinforcing the stability of firms and the financial system.

   a. First, compensation plans should properly measure and reward performance.

   b. Second, compensation should be structured to account for the time horizon of risks.

   c. Third, compensation practices should be aligned with sound risk management.

   d. Fourth, we should reexamine whether golden parachutes and supplemental retirement packages align with the interests of executives and shareholders.

e. Finally, we should promote transparency and accountability in the process of setting compensation.

Many of the compensation practices that encouraged excessive risk-taking might have been more closely scrutinized if compensation committees had greater independence and shareholders had more clarity. In too many cases, compensation committees were not sufficiently independent of management, while companies were not fully transparent in explaining their compensation packages to shareholders. In addition, existing disclosures typically failed to make clear in a single place the total amount of "walkaway" pay due to a top executive, including severance, pensions, and deferred compensation.

We intend to work with Congress to pass legislation in two specific areas. First, we will support efforts in Congress to pass "say on pay" legislation, giving the Securities and Exchange Commission (SEC) authority to require companies to give shareholders a non-binding vote on executive compensation packages. "Say on pay" – which has already become the norm for several of our major trading partners, and which President Obama supported while in the Senate – would encourage boards to ensure that compensation packages are closely aligned with the interest of shareholders.

Second, we have proposed legislation giving the SEC the power to ensure that compensation committees are more independent, adhering to standards similar to those in place for audit committees as part of the Sarbanes-Oxley Act. This legislation would also give compensation committees the responsibility and resources to hire their own independent compensation consultants and outside counsel.

6. **I appreciate the Department's regulatory change to permanently end the restrictions on travel to Cuba by Cuban-Americans visiting their families. This issue was also addressed by this subcommittee in the fiscal year 2009 Appropriations Act. Is the Department willing to go further, and make it easier for non-Cuban Americans to travel to Cuba for educational, religious, or research purposes, or to expand people-to-people contact, as was the case during the Clinton Administration?**

Treasury stands ready to implement the policies of the President with respect to travel to Cuba. The President's initiative of April 13, 2009 focused on family visits, remittances, and telecommunications. The Administration continues to evaluate whether additional changes in Cuba policy would help advance our broader policy objectives.

7. **Since OFAC enforcement of Cuba family travel restrictions is no longer necessary, will OFAC now have additional resources freed up to target the financial support networks of terrorist groups such as al Qaeda?**

Protecting our national security is the Office of Foreign Assets Control's (OFAC) paramount responsibility. As such, OFAC directs the great majority of its resources toward top priority threats such as counterterrorism and counter-proliferation.

Certain provisions of the Omnibus Appropriations Act, 2009, will, in the short to medium term, begin to allow OFAC to reallocate limited resources previously applied to the Cuba program. As resources become available, OFAC will direct them to meet its growing responsibilities in addressing national security and US foreign policy priorities.

8. **As part of its transition to the more restrictive rules governing payment for agricultural and medical goods shipped to Cuba, the Bush Treasury Department expressly allowed shipments made prior to a specified date to proceed on a cash-in-advance-of-delivery basis. If the Bush Treasury Department could legally permit those shipments, why does the present Treasury Department insist that it cannot?**

In 2005, OFAC authorized the processing of payments received for shipments that left the United States within the 30 days following issuance of the 2005 regulatory amendment, even if those payments did not result from payment or financing terms that met the Trade Sanctions Reform and Export Enhancement Act's (TRSA) cash in advance requirement (the meaning of which OFAC clarified in the same regulatory amendment). This limited authorization was issued in order to avoid disrupting agricultural exports to Cuba that were already in motion.

Treasury's position is that TSRA does not prohibit OFAC from exercising the existing licensing authority to allow the processing of payments that would otherwise have been blocked because they were prohibited under TRSA. The authorization to process such payments did not render any underlying prohibited payment or financing terms valid, and thus, for example, would not have precluded OFAC's initiation of enforcement proceedings against persons who arranged underlying payment or financing terms in contravention of TSRA, as appropriate.

9. **Will the Department commit to consult with the subcommittee before making further commitments with respect to Cuba regulations?**

The Department will continue to consult with the subcommittee.

10. **My office has heard from Cuba travel license applicants whose applications have remained pending at OFAC for multiple years. What does the Department consider a reasonable timeframe for OFAC to respond to a license applicant?**

When OFAC's Licensing office is fully staffed, the vast majority of Cuba travel applications are processed in fewer than 30 days. It is unusual for travel applications to be pending for multiple years. Applications that take longer periods of time may involve unusual circumstances. For example, an application may be pending for a longer time than usual to await the outcome of a related policy review. It is always OFAC's intent and practice to respond to applications in a timely manner whenever possible.

11. **What is the projected total cost of the Treasury Annex building renovation project?**

A full renovation has been estimated to cost between $100 million to $120 million. Treasury elected to repair key systems and completely renovate several offices within the Annex. The $11.5 million provided in FY 2009 and the $4.5 million requested in FY 2010, for example, will support repairs to the Annex's electrical and elevator systems.

12. **The fiscal year 2010 budget request for the Treasury Office of Inspector General is $26,700,000, an increase of 2.2 percent over fiscal year 2009. Will this amount be sufficient to cover both material loss reviews in the cases of failed banks, as well as the OIG's mandated and planned audits and investigations?**

Based on the best information we have to date, the FY 2010 budget request will permit the OIG to meet its responsibilities, including material loss reviews. With the FY 2010 request, the OIG is able to retain the larger workforce that was approved for FY 2009, an increase of 39 FTEs, or nearly 34 percent, over the FY 2008 level.

13. **What is the estimated total cost of the effort to modernize the information technology of the Office of Debt Management (for which $3 million is assumed in both the fiscal year 2009 and fiscal year 2010 budgets)?**

The modification of the Office of Debt Management's information technology systems has a total cost of approximately $9.6 million over three years beginning in fiscal year 2009. These funds are being used to revamp the Office of Debt Management's obsolete information technology systems. Annual recurring costs for systems operation and maintenance are estimated at $2 to $2.5 million. The initial system launch is scheduled for November 2009.

14. **How does the proposed Alcohol and Tobacco Tax and Trade Bureau user fee differ from the TTB user fee proposals contained in the fiscal year 2007 and 2008 budget requests?**

The President's FY 2010 Budget proposes language establishing an ongoing permanent "fee" program for FY 2010 and each fiscal year thereafter, requiring members of the alcohol industry to pay annual licensing and registration fees. The fees range from $300 to $1,000, depending on the type and size of the business entity. In the first year, the annual estimated offsetting receipt collections will be lower, but it is anticipated that the annual collections from the program will fully fund agency operations.

Prior user fee proposals would have charged fees to industry members for direct services activities such as the issuance of permits and issuance of a certificate of label approval. These user fees would have been assessed on alcohol producers, with the amount of recovery limited to specific regulatory activity. The recovery amount would have only provided funding for a portion of TTB's regulatory program. The FY 2010 fee proposal is a licensing and registration fee which applies to all industry members participating in this multi-tier distribution system, including retail dealers, with the assessed amount equivalent to the total resources necessary for TTB to continue its regulatory and tax collection efforts.

15. **The fiscal year 2010 budget request for the Treasury Inspector General for Tax Administration is $149,000,000, an increase of 2 percent over fiscal year 2009. Will the new Enforcement initiatives in the fiscal year 2010 budget request lead to additional workload for TIGTA, and if so, is there a risk that a 2 percent funding increase for TIGTA will not sufficiently enable TIGTA to fulfill all its responsibilities?**

The FY 2010 budget request is adequate for the Treasury Inspector General for Tax Administration (TIGTA). While it is true that IRS enforcement initiatives are set to increase in FY 2010, TIGTA was able to fulfill all of its responsibilities during FY 2009 when enforcement initiatives increased at a similar rate. (The IRS enforcement budget increased by 7.1 percent in FY 2009 and is set to increase by 7.6 percent in FY 2010.) We will continue to track TIGTA's workload as IRS enforcement initiatives increase.

16. **What budget assumptions went into the Department's proposal to rescind $50,000,000 from the Treasury Forfeiture Fund?**

The Department's proposal to rescind $50,000,000 from the Treasury Forfeiture Fund is based on the anticipation of several large forfeiture deposits. The Department believes that the rescission will not adversely affect the operations of the Treasury Forfeiture Fund, or prevent high priority federal law enforcement initiatives from being funded.

17. **How does the Treasury Department plan to spend the additional funds that were provided in fiscal year 2009, above the amount assumed in the budget request, for the Office of Financial Education?**

The mission of the Office of Financial Education is to promote access to the financial education tools that can help all Americans make wiser choices in all areas of financial management. When the additional funding was provided, the Department was directed to target these resources toward grades K-12 and financial education efforts aimed at preventing predatory lending. Thus, our spending is focused in these two areas. For the K-12 efforts, we plan to improve outreach and resources, including expansion of the Office's National Financial Literacy Challenge, which is a high school program that motivates students to become educated about personal money management and provides recognition and prizes for top performers. Roughly 120,000 students participated in 2008. The Office is using a portion of the additional funding provided in FY 2009 to improve the program, develop a teacher tool and expand the Challenge to more high schools, particularly in underserved areas. We are also working with the Department of Education on elementary school efforts. We are also using the funding to combat predatory lending, including an outreach campaign through traditional and new media in English and Spanish to promote sound borrowing in order to help borrowers avoid predatory loans and other unwise financial products. In addition, we will be conducting research to ensure that our efforts in these areas are as effective as possible.

18. **What is the status of FinCEN's cross-border wire transfer initiative, including the $2,500,000 provided for this purpose in the fiscal year 2008 Appropriations Act?**

    The Financial Crimes Enforcement Network (FinCEN) made significant progress in both identifying the implications and benefits of requiring reporting of cross-border electronic transmittals of funds and formulating possible rule text during the last Administration. We are carefully reviewing these materials and the imposition of any such requirement will only be undertaken through the official rulemaking process which will include ample opportunity for public notice and comment prior to the implementation of any reporting requirement. $2.5 million in FY 2008 appropriated funds remains unobligated.

19. **How much did the Treasury Department spend on outside contracts in fiscal year 2008?**

    $4,340.3 million.

20. **For fiscal year 2008, how much did the Treasury Department rely on contracts that were not fully and openly competed?**

    $740 million (17 percent of total obligation).

21. **Please provide a listing of all of the Treasury Department's fiscal year 2008 outside contracts of $200,000 or more, along with the purpose of each contract. In the listing, please indicate which contracts were not fully and openly competed.**

[NOTE: The detailed listing is available at the office of the Financial Services subcommittee.]

Please see the attached list. Attachment includes all FY 2008 transactions of $200,000 or more. Transactions include each contract as well as each order, and modification to existing contracts that exceeds $200,000. System limitations do not allow us to consolidate each contract with its related orders and/or modifications in order to report only aggregate contracts over $200,000.

22. How many contract employees now work in space with the regular civil service employees of the Treasury Department?

Treasury bureaus report a total of 6,802 contractor employees performing work in space with civil service employees. Contracts vary greatly by purpose, scope and duration, and bureau systems vary in the way they track contractor employee data. For example, these numbers reflect employees who perform work full-time on site all year as well as employees of contractors on site only intermittently or for short duration.

23. Please provide a list of how many contract and civil service employees now work in each major location (more than 100 total employees) maintained by the Treasury Department.

The Treasury Department currently has 123 geographic locations with more than 100 employees. Please see the attached excel file for the listing of contractor and civil service employees in each of these locations.

24. Has the Treasury Department collected demographic data (including income, race and disability status) on the persons who occupy Low-income Housing Tax Credit (LIHTC) properties?

Pursuant to section 36 of the U.S. Housing Act of 1937, as amended by section 2835(d) of the Housing and Economic Recovery Act of 2008, the Department of Housing and Urban Development, not the Treasury Department, gathers data relating to the LIHTC. See 59 Fed. Reg. 14,149 (March 30, 2009).

25. What percentage of LIHTC units are made available to Section 8 voucher holders? To persons with disabilities?

Pursuant to section 36 of the U.S. Housing Act of 1937, as amended by section 2835(d) of the Housing and Economic Recovery Act of 2008, the Department of Housing and Urban Development, not the Treasury Department, gathers data relating to the LIHTC. See 59 Fed. Reg. 14,149 (March 30, 2009).

26. With regard to "local veto" requirements, how extensively do housing finance agencies require or encourage approval or support by local jurisdictions as a prerequisite for LIHTC funding being used, particularly in New York and California?

Because this question relates to requirements of local jurisdictions, rather than to Federal tax law, the Department of the Treasury is unable to comment.

27. **Are LIHTC rental units being affirmatively marketed to persons least likely to apply?**

Because the LIHTC provision as set forth in section 42 of the Internal Revenue Code does not create such an "affirmative marketing" requirement, the Department of the Treasury would not have responsive information. Nevertheless, upon audit, the IRS would make sure that LIHTC properties are placed in service, at which point marketing efforts would be relevant.

28. **Has the August 2000 Memorandum of Understanding (MOU) among the Departments of Treasury, Justice, and Housing and Urban Development been fully implemented?**

Yes, the MOU has been fully implemented.

29. **Has Treasury, or any of the parties to the MOU, conducted a review of the operation of the MOU since August 2000? What, if any, research have Treasury and/or HUD conducted since 2000 concerning LIHTC properties?**

The Treasury and IRS have not engaged in any research in cooperation with HUD or the Department of Justice under paragraph 5 of the MOU.

30. **Has the Treasury Department convened or participated in any meetings, since 2000, to discuss emerging civil rights issues and new methods and programs to increase civil rights compliance in the LIHTC program?**

No.

31. **Have staff persons been identified by the IRS to provide technical assistance and training to personnel from the Departments of Justice and Housing and Urban Development on general tax administration issues under the LIHTC program, per section 2 of the MOU?**

Yes, a staff person in the Small Business/Self Employed Division of the IRS is designated to provide technical assistance and training as needed. To date, no requests for such training have been received.

QFR #22: How many contract employees now work in space with the regular civil service employees of the Treasury Department?

Total Number of Contractors	
Treasury wide	6,802

QFR #23: Please provide a list of how many contract and civil service employees now work in each major location (more than 100 total employees) maintained by the Treasury Department.

State	City	TOTAL CIVIL SERVICE	TOTAL CONTRACTOR
AL	BIRMINGHAM	184	0
AL	HOMEWOOD	186	50
AR	LITTLE ROCK	161	0
AZ	PHOENIX	439	0
CA	EL MONTE	284	0
CA	EL SEGUNDO	173	1
CA	FRESNO	7,741	194
CA	GLENDALE	278	0
CA	LAGUNA NIGUEL	609	0
CA	LONG BEACH	153	0
CA	LOS ANGELES	771	8
CA	OAKLAND	995	8
CA	SACRAMENTO	343	3
CA	SAN BERNARDINO	222	0
CA	SAN DIEGO	303	5
CA	SAN FRANCISCO	1,086	49
CA	SAN JOSE	432	0
CA	SANTA ANA	221	0
CA	TULARE	248	0
CA	VAN NUYS	113	0
CA	WALNUT CREEK	112	0
CO	DENVER	1,384	6
CO	ENGLEWOOD	128	3
CT	HARTFORD	210	0

State	City	TOTAL CIVIL SERVICE	TOTAL CONTRACTOR
CT	NEW HAVEN	125	0
DC	WASHINGTON	9,325	1,926
FL	JACKSONVILLE	1,390	0
FL	MAITLAND	178	1
FL	MIAMI	320	1
FL	PLANTATION	523	2
FL	ST PETERSBURG	111	0
FL	TAMPA	232	0
FL	WEST PALM BEACH	114	0
GA	ATLANTA	2,201	58
GA	CHAMBLEE	4,367	161
GA	GLYNCO	164	0
HI	HONOLULU	140	0
IA	DES MOINES	115	0
ID	BOISE	106	0
IL	BLOOMINGTON	394	2
IL	CHICAGO	1,104	15
IL	DOWNERS GROVE	334	0
IL	SCHILLER PARK	213	0
IN	INDIANAPOLIS	643	0
KS	WICHITA	122	0
KY	(NO CITY)	202	0
KY	COVINGTON	4,280	219
KY	FLORENCE	512	17
KY	LOUISVILLE	191	0
LA	NEW ORLEANS	292	0
MA	ANDOVER	1,588	55
MA	BOSTON	543	6
MA	FITCHBURG	206	0
MA	LOWELL	570	2
MA	METHUEN	536	0
MA	STONEHAM	211	1

State	City	TOTAL CIVIL SERVICE	TOTAL CONTRACTOR
MD	BALTIMORE	744	2
MD	HYATTSVILLE	866	327
MD	NEW CARROLLTON/ LANDC	3,510	1,078
MD	OXON HILL	408	48
MD	WHEATON	105	0
MI	DETROIT	1,427	110
MI	FARMINGTON HILLS	116	0
MI	GRAND RAPIDS	123	0
MI	PONTIAC	113	0
MN	BLOOMINGTON	136	1
MN	BROOKLYN CENTER	125	0
MN	MINNEAPOLIS	124	0
MN	ST PAUL	309	4
MO	KANSAS CITY	6,044	632
MO	ST LOUIS	1,013	0
MO	TOWN AND COUNTRY	209	0
MS	JACKSON	132	0
NC	CHARLOTTE	366	12
NC	GREENSBORO	290	0
NE	OMAHA	168	0
NJ	CHERRY HILL	105	0
NJ	EDISON	180	0
NJ	JERSEY CITY	135	0
NJ	MOUNTAINSIDE	175	0
NJ	SPRINGFIELD	169	0
NM	ALBUQUERQUE	133	0
NV	LAS VEGAS	317	6
NY	ALBANY	138	2
NY	BUFFALO	272	0
NY	CHEEKTOWAGA	837	1
NY	GARDEN CITY	241	0
NY	HAUPPAUGE	131	0

State	City	TOTAL CIVIL SERVICE	TOTAL CONTRACTOR
NY	HOLTSVILLE	3,355	68
NY	NEW YORK	2,376	31
NY	ROCHESTER	100	2
NY	SYRACUSE	110	0
NY	WEST POINT	186	3
OH	CINCINNATI	1,165	41
OH	CLEVELAND	537	3
OH	COLUMBUS	191	0
OH	INDEPENDENCE	255	8
OK	OKLAHOMA CITY	373	0
OK	TULSA	140	0
OR	PORTLAND	581	0
PA	KING OF PRUSSIA	120	0
PA	PHILADELPHIA	5,685	204
PA	PITTSBURGH	759	0
PR	GUAYNABO	559	0
SC	COLUMBIA	140	0
TN	MEMPHIS	2,713	156
TN	NASHVILLE	982	5
TX	AUSTIN	6,672	290
TX	DALLAS	1,467	9
TX	FARMERS BRANCH	908	99
TX	FORT WORTH	803	300
TX	HOUSTON	1,209	7
TX	SAN ANTONIO	604	0
UT	CLEARFIELD	132	0
UT	OGDEN	6,285	200
UT	SALT LAKE CITY	232	0
VA	RICHMOND	653	8
VA	VIENNA	269	105
WA	SEATTLE	1,130	0
WI	MILWAUKEE	267	2

State	City	TOTAL CIVIL SERVICE	TOTAL CONTRACTOR
WV	BECKLEY	247	29
WV	MARTINSBURG	951	115
WV	PARKERSBURG	1,938	101
Total		**111,383**	**6,802**

Questions from Rep. Barbara Lee:

32. Many of the TARP and TALF programs require massive minimum purchases of $500 million dollars or $10 billion under management to qualify to participate in auctions or to bid on fund management work.

a. Can you tell the subcommittee which of the Treasury's loan or asset purchase programs targets small businesses and if there is any aid for non-profit service groups who are experiencing dramatic declines in their funding?

i. Restarting Flow of Credit to Small Businesses is A Major Priority of Our Financial Stability Plan: A major goal of Treasury's efforts to stabilize the financial system, restart secondary markets and ensure banks have the capital necessary to lend even in a worse-than-expected economic scenario is to get credit flowing again to the small businesses that have always been critical to job creation in our country, but could be particularly important in speeding us to economic recovery.

ii. We Put Forward A Coordinated Strategy During the Transition Directed At Small Businesses: Since the transition, we have – working with the Small Business Administration (SBA) and Congress – pursued a strategy of combining an increase in SBA loan guarantees and a reduction of loan fees with aggressive efforts to get secondary markets flowing again. In keeping with that strategy, we have introduced an initiative of direct purchases on the secondary markets for SBA 7(a) loans, which, combined with an increase in loan guarantees to 90 percent and the temporary elimination of fees under the Recovery Act, should provide banks with the confidence to make new loans.

iii. We Have Worked To Improve Terms Under TALF To Ensure Small Businesses Can Benefit: After market participants suggested that the terms under TALF would not attract investors into SBA-backed securities, Treasury worked to revise those terms to increase participation. Since May, when SBA asset-backed securities were included as collateral under TALF for the first time, more than $300 million has been lent against these securities. Treasury also expanded the program to include securities backed by commercial real-estate loans, equipment loans and leases, and auto loans and leases- all important sources of credit for small businesses across the country.

iv. We Created New Reporting Requirements to Track Small Business Lending by the Largest TARP Recipients: Since April, the TARP monthly lending survey, which tracks the 21 largest banks receiving TARP funds, has included data on small business lending, allowing us to better monitor the impact of Treasury's efforts on small businesses. In addition, Treasury is working with regulators to require all banks to report their small business lending in their quarterly call reports, rather than simply once a year.

v. We Are Seeing Some Positive Signs in SBA Lending Markets: The announcement impact of the direct purchase program has contributed to increased activity in SBA secondary markets. Activity in the 7(a) secondary market - which had fallen to below $100 million in December and January - has picked up, with $324 million in total loan volume settled from lenders to brokers in July. The implementation of higher SBA loan guarantees and reduced fees, along with improved liquidity for lenders, has boosted small business lending. Since March 16, average weekly SBA loan volumes are up over 50 percent compared to the weeks before the announcement.

b. Will these staggeringly high limits shut out smaller companies who may actually be in a better position to be more agile and effective, or may have better local knowledge and awareness of the real estate markets?

With respect to the Legacy Securities Public Private Investment Program (S-PPIP), to ensure a diversity of participation, Treasury has encouraged small, veteran, minority- and women-owned private asset managers to partner with other private asset managers, if necessary, in order to meet the minimum criteria for assets under management and the ability to raise private capital. Treasury is pleased to announce that all pre-qualified fund managers have established meaningful partnership roles for small businesses and veteran-, minority- and women-owned businesses. These roles include asset management, capital raising, broker-dealer services, and other critical services such as research, risk management, investor relations and legal services.

c. What can Treasury do to proactively reach out to minority and women owned firms to ensure their participation in the nation's economic recovery?

We believe it is essential that the TARP be structured in a manner that encourages participation of small businesses, veteran-owned businesses, and minority and women-owned businesses.

We have experienced several challenges in increasing small, minority, women- and veteran-owned business participation. The call for immediate response to economic crises has dictated compressed timeframes for performance. TARP initiatives require highly specialized expertise in financial and legal structures not readily available in the small business community. Several programs require contractors to provide staff licensed in multiple jurisdictions, and the capacity to send teams of experts to multiple locations for concurrent negotiations or transaction closings. Taken together, these factors limit the number of businesses capable of successfully meeting TARP requirements.

We strive to actively encourage the participation, and to provide meaningful opportunities for small, minority-, veteran-, and women-owned businesses. We research corporate capabilities prior to soliciting offers for goods and services. Our research is supported by our Office of Small and Disadvantaged Business Utilization (OSDBU), the Small Business Administration (SBA), and other resources to help identify potential small, minority-, veteran-, and women-owned businesses capable of performing the required work. We request proposals from as many sources as practicable under the urgent and compelling circumstances surrounding the TARP, and target small, minority-, veteran-, and women-owned businesses as part of our competitions.

Where small business set-aside contracts have proven infeasible, and where subcontracting opportunities exist, we have required small business subcontracting plans to contain specific performance goals. We evaluate the small business subcontracting plans as we review incoming proposals, and assess their commitment to providing meaningful opportunities to small businesses in various socioeconomic categories. Our contractors are required to submit performance data against those goals directly to the Small Business Administration's electronic subcontracting system (eSRS) website. Small business subcontracting performance is integral to our contract performance management and reporting process. Prime contractors that fail to make a good faith effort to achieve their subcontracting goals are appropriately rated in the government-wide Past Performance Information Retrieval System (PPIRS) and are subject to liquidated damages penalties.

d. Given the very high minimums set, I am concerned that the only companies that will be able to participate in the rescue of our economy will be the very companies that were at the center of the crisis in the first place. Can we be assured that outside companies will have access and what systems are in place to ensure that there will be no collusion between major banks to control the prices of the assets at auction?

Treasury has encouraged prospective PPIP fund managers to partner with or subcontract to smaller entities, and many of the leading fund manager candidates have done so. Such arrangements may include provision of subadvisory services or even delegation of responsibility for managing a discrete portion of the PPIF's investments. With respect to the risk of collusion, Treasury has developed, in consultation with SIGTARP and the Federal Reserve Bank of New York, a robust and comprehensive set of procedures and requirements to eliminate or mitigate fund manager conflicts of interest and to ensure that their financial interests are aligned with those of investors in the PPIF, including the taxpayers. Treasury will devote whatever resources are necessary to ensure compliance with these requirements and is in the process of expanding its compliance staff and hiring outside consultants for that purpose.

33. **If a financial services corporation or broker or dealer of derivatives such as mortgage backed securities or other collateralized debt obligations sells those securities to clients as sound investments while simultaneously holding credit default swaps (CDS) against the performance of those same or similar classes or assets and fails to either offer the same CDS's to the client or fails to disclose the existence of those CDS's, in the opinion of the Treasury, would constitute a fraud, breach of fiduciary responsibility or gross negligence on behalf of the sellers?**

    This is not an issue that falls within the jurisdiction of the Department of Treasury and should be directed to the Securities and Exchange Commission (SEC).

34. **Is the Treasury aware of any entities which received TARP or TALF or other federal funds who also were paid on CDS's held by AIG or any other companies?**

    Yes. Treasury is aware that firms that received federal assistance directly from TARP may have also benefited indirectly from federal support for A.I.G. and others, such as collateral postings on credit default swaps (CDS) trades.

35. **Is the Treasury Department sharing any information that they have with relevant offices at the Securities and Exchange Commission, the Federal Reserve, the Office of the Comptroller of the Currency or any other office which would have the jurisdiction to investigate any wrongdoing?**

    It is Treasury Department policy to share information it has with relevant offices at the Securities and Exchange Commission (SEC), the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and other offices having jurisdiction to investigate wrongdoing, for their use in performing their official duties. Treasury Department regulations governing the disclosure of Treasury

Department records state (at 31 C.F.R. §1.12) that they do not apply to official requests of other governmental agencies or officers acting in their official capacity, unless it appears that a particular request would be in violation of law or inimical to the public interest.

36. **Is the Treasury Department aware of any civil suits that seek damages based on this line of reasoning and are they co-operating by offering information of any kind?**

The Treasury Department is not aware of civil suits between financial services corporations, brokers or dealers of derivatives and their clients that seek damages for having sold derivatives to clients as sound investments while simultaneously holding credit default swaps (CDS) against the performance of those assets and failing to disclose the existence of the CDS to the client or offer the same CDS to the client. Treasury Department regulations set out detailed procedures (at 31 C.F.R. §1.11) for litigants in court cases in which the United States or the Treasury Department is not a party to follow to obtain testimony or documents from Treasury Department employees. It is Treasury Department policy not to provide testimony by current or former Treasury Department employees or Treasury Department documents in court cases in which the United States or the Treasury Department is not a party except as provided in the regulations.

37. **The Administration has begun to limit the executive compensation of companies that have received TARP funds. Can you tell the committee if you believe that the way in which current tax law allows the deductibility of various forms of compensation, might encourage the growth of excessive levels of executive compensation?**

Two current provisions of the Internal Revenue Code restrict the tax deductions available to an employer for payments of executive compensation. Section 162(m) limits the deduction for compensation paid to the named executive officers whose compensation is required to be disclosed in the annual proxy under the federal securities laws (generally the CEO, the CFO and the next three most highly compensated executive officers) to $1 million, unless the compensation paid consisted of performance-based compensation. Section 280G limits the deduction available for excess golden parachute payments upon a change in control of a corporation, generally limiting the deduction to three times the executive's annual compensation.

However, the task of formulating compensation structures and levels for executives ultimately falls to the company's board of directors, typically the board's compensation committee. Their goal should be to adopt compensation practices that are closely aligned with the interests of the shareholders and, in the case of financial institutions, which reinforce the stability of the institution and the financial system. Accordingly, we are giving attention to the various factors that influence the formulation of executive compensation, with a view to promoting practices that encourage sound risk management and that align the benefits for market participants with long-term growth and value creation—not only at individual firms, but for our financial system and the economy as a whole.

38. **Would limits to the tax deductibility of executive pay packages reign in some of the out of control pay packages that we have seen in recent years?**

    To improve process and outcomes with respect to pay packages, we have recommended legislation that would give the Securities and Exchange Commission (SEC) the authority to require non-binding annual say-on-pay votes for all public companies, and would give compensation committees greater independence by directing the SEC to promulgate rules requiring companies listed on national securities exchanges to meet exacting standards for independence. Under these rules, not only would compensation committee members be truly independent from management, but the committee's compensation consultants and legal counsel would be answerable only to the committee. These recommendations are included in the Treasury Secretary's June 10, 2009, statement on compensation. The statement also articulates a set of principles for executive compensation policy and advances several specific legislative and other proposals. The statement is available at: http://www.financialstability.gov/latest/tg-163.html.

39. **The Treasury Department will soon deliver a report on the allocation of resources and their efforts regarding the Office of Foreign Asset Control and the enforcement of Cuba embargo related actions and administration. Can the Treasury Department regularly update the subcommittee on the on-going use of Treasury resources to enforce the embargo and related licensing actions?**

    Treasury continues to dedicate sufficient resources to fulfill its obligation to administer the Cuban Assets Control Regulations, as it would any U.S. Government sanctions program. The Administration will continue to consult with Congress on a regular basis.

40. **We have passed two large stimulus packages in an effort to stabilize our faltering economy. We know that increased spending on infrastructure projects and direct payments like refunds, refundable tax credits and extended unemployment benefits will not only help those receiving the benefits, but will stimulate the economy by increasing demand. Mr. Secretary, will increasing the minimum wage, providing universal healthcare and guaranteeing access to affordable housing also stimulate the economy?**

    When the U.S. economy is operating below potential, both monetary and fiscal policy are helpful in providing a temporary boost to demand that can create jobs and save jobs that otherwise would have been lost. We agree that tax refunds, tax credits, and extended unemployment insurance not only help families that receive funds directly, but also help the economy through important, second-round spending effects. Ensuring universal access to quality health care can make our labor markets more flexible, strengthening the resilience of the overall economy.

41. **Does the Treasury have any estimates for how much we can save our constituents if private health insurance plans actually had to compete with a public health insurance option?**

    The President believes that health reform must be built on three fundamental principles: it must lower the skyrocketing cost of health care; guarantee choice of doctors and plans; and ensure quality affordable health care for every American.

    The precise impact of a public plan will ultimately depend on its design and on the overall framework of health reform. The Administration is working with Congress to determine this framework.

42. **What are you doing to get the message out about the importance of having a public health insurance option be included as part of health reform?**

    As President Obama has said, a public health insurance option would create market competition, which means more choices and better treatment for consumers. Such an option would also lower costs throughout the health care system.

43. **Will you provide the Subcommittee with information regarding the diversity of the professional full time employees at the Treasury Department? What is Treasury doing to ensure that it is recruiting and hiring a diverse staff including from different race and ethnicities?**

    Treasury is committed to ensuring that we have a well-qualified workforce that reflects the diversity of our nation. Because managers are always advised to hire the most qualified candidates, we aim to ensure that Treasury attracts the widest possible pool of talent from which the hiring manager can select the most qualified applicant. Internally, our proactive efforts include:

    - Establishing the Human Capital Advisory Council (HCAC) comprised of representatives from the Treasury bureaus' Human Resources (HR) and Equal Employment Opportunity (EEO) Offices who work together to ensure the HR and EEO communities collaborate on overall goals and objectives, including joint bureau recruiting and outreach activities.
    - The HCAC has hosted two Recruiters' Symposiums, bringing together bureau representatives and recruiting experts to share best practices in recruitment and to explore leveraging Treasury as a whole to increase its marketability as an employer.

- In FY 2008, the Treasury Executive Institute offered a total of 108 programs and trained more than 4,350 Treasury leaders, including at least eight programs focused on valuing diversity in the workplace, understanding cultural differences, and cross cultural communications

The results of our outreach efforts (see below) are as follows:

- According to the US Office of Personnel Management's FY 2008 Federal Equal Opportunity Recruitment Program (FEORP) report, Treasury ranked third of 18 Executive Departments in its representation of both Hispanic employees (with an 8.7% participation rate and a government-wide participation rate of only 7.9%) and Black employees (with a participation rate of 24.7% and a government-wide participation rate of 17.9%). Treasury also exceeded the government-wide participation rate for women (with a 62.9% participation rate and a government-wide participation rate of 44.2%). The FY 2008 FEORP report also cited Treasury's Human Capital Strategic Plan and Human Capital Operating Plan as 'best practice' examples for long-term goals and strategies that are outcome-based.
- According to the US Equal Employment Opportunity Commission's upcoming FY 2008 Annual Report on the Federal Workforce, Treasury has the highest participation rate of all Cabinet agencies for individuals with targeted disabilities (1.7%) and was one of only three Cabinet-level agencies to increase its number of severely disabled employees in FY 2008.

a. Can you describe some of the outreach efforts that Treasury is conducting?

i. Outreach to High School and College Students

- Treasury conducts on-site campus visits to minority serving institutions in addition to periodic calls, emails, and mailings providing mission related information and/or vacancy announcements.
- Treasury has had a long and active partnership with the Hispanic College Fund and is one of the sponsors of the Hispanic College Fund's Greater Washington Youth Symposium at Trinity University in Washington, DC. Treasury not only provides financial support, but also serves on the Symposium's planning committee and provides workshop panel members, mentors and volunteers during the event. By reaching out to these students now, the Department is able to

position itself as an employer with exciting careers and internship opportunities.

- As a way to develop a pipeline of Hispanic employees, Treasury maintains a partnership with the Hispanic Association of Colleges and Universities' (HACU) Hispanic Serving Institutions National Internship Program (HNIP). During FY 2008, Treasury placed 57 HACU interns in six bureaus.
- The Department contacted (via mailings, emails or phone) and/or participated in on-site recruitment activities at the following Tribal Colleges and Universities: Navajo Technical College, Southwestern Indian Polytechnic Institute, Tohono O'odham Community College, Dine' College, Haskell Indian Nation University, Little Priest Tribal College, Lac Courte Oreilles Ojibwa Community College, College of Menomonee Nation, Fort Lewis College, Bay Mills Community College, Saginaw Chippewa Tribal College, Cankdeska Cikana (Little Hoop) Community College, Sitting Bull College, Chappaquiddick Tribe of the Wampanoag Indian Nation Northern Essex Community College, Fond du Lac Tribal and Community College, and Fort Berthold Community College.
- The Department also advertised in the Winds of Change, Tribal College Journal, Indian Country Today, and The Official Diversity Career Guide (distributed to 19 tribal colleges) in an effort to promote Treasury's mission and occupations.
- Other external internship programs also provide Treasury with avenues to expand the pools of potential candidates in mission critical occupations, including: the Washington Internship Program for Native Students (WINS, with 11 interns in FY 2008), the Workforce Recruitment Program (WRP, focusing on individuals with disabilities, with 8 interns in FY 2008) and the Thurgood Marshall College Fund (TMCF, with 3 interns in FY 2008). To enhance the intern experience, all summer interns are provided brown bag sessions with senior leaders, tours of Treasury facilities, networking opportunities, and professional development seminars.

ii. Hiring Individuals with Disabilities:

- In FY 2008, Treasury participated in two career fairs hosted by Operation Warfighter (OWF) at the Walter Reed Army Medical Center and in FY 2009, set goals to place OWF candidates, to identify other avenues to improve the hiring of disabled veterans, and to promote Treasury within the disabled veterans' community, including placing ads in Ability Magazine and PN, a magazine published by Paralyzed Veterans of America, Inc. The Financial Management Service, Internal Revenue Service, Office of Thrift Supervision, U.S. Mint, and Departmental Offices participated in job fairs and/or workshops sponsored by OWF. Moreover, representatives from the Financial Management Service, Internal Revenue Service, U.S. Mint, Office of Thrift Supervision, and Departmental Offices were in constant contact with OWF placement coordinators throughout the fiscal year.

- In October 2008, Treasury hosted its first disABILITY Summit and Career Fair and a second event is scheduled for October 2009. The Career Fair, which attracted numerous candidates, provides Treasury's bureaus an opportunity to connect with qualified candidates with disabilities, while the Summit educates Treasury's managers on the advantages of using special appointing authorities to quickly fill positions with highly qualified applicants. The second summit and job fair is planned for October 8-9, 2009.
- Since 1967, the Internal Revenue Service has partnered with Lions World Services for the Blind to form the Lions World Program. Under the arrangement with Lions World Services, the IRS extends commitments to hire qualified individuals with visual impairments referred for consideration. Initially, the Lions World Program prepared candidates for customer (taxpayer) service representative positions. In 1984, the program was expanded to include preparing candidates for contact collection representative positions and, in 1991, was further expanded to prepare candidates for service center collection representative positions. As of FY 2007, 673 persons with significant visual impairments have been hired by the IRS through this program, and the IRS had also directly hired 126 visually impaired computer programmers recommended by Lions World Services.

iii. Hiring Veterans

- In FY 2008, the Department also disseminated job vacancy information at the Military Stars, Salute Our Heroes, Department of Defense Hiring Heroes, Hire a Hero, Hire a Veteran, Veterans Career and Resource Fair, Recruit Military, Military World Expo, Corporate Gray, Paralyzed Veterans of America, Veterans of Foreign Wars, American Legion, Stars and Stripes, and the Military Officers Association of America career fairs.
- Treasury's bureaus make use of special hiring programs, such as the Veteran Recruitment Appointment (VRA) and the Veterans Employment Opportunities Act (VEOA), to appoint veterans and the Department's FY 2008 Disabled Veterans

Affirmative Action Program (DVAAP) report reflects the hiring of over 1,000 veterans.

- In order to reach disabled veterans, Department vacancies were disseminated to organizations and agencies working with disabled veterans such as the Vocational Rehabilitation Agencies, Disabled American Veterans, G.I. Forum, Paralyzed Veterans of America, Blinded Veterans Association, Black Veterans Association, Non-Commissioned Officers Association of America, state and local employment agencies, Department of Defense, Department of Veterans Affairs, Cuban American Veterans Association and the Employee Assistance and Recruitment Network (EARN).

iv. Other Outreach and Related Activities

- Treasury offices send vacancy announcements to a wide ranging list of diversity organizations, including Campus Publications Northern-Southern Diversity Schools, Black MBA, Black Collegian, Job Postings Magazine, Equal Opportunity Magazine, BlackVoice.com, HBCU Network, and The Official Diversity Career Guide.
- Treasury attends minority professional organizations' career fairs, conferences, and conventions in order to recruit diverse candidates for mid- to senior-level positions. The Department also purchases promotional advertising spots on the web and in print publications and the bureaus have advertised on minority job boards, in minority publications, and in newspapers which reach minority publications.
- The Office of the Comptroller of the Currency (OCC) also has an active college recruitment program for its Bank Examiner positions which includes building relationships at many colleges and universities across the country, including Hispanic Serving Institutions and Historically Black Colleges and Universities.

44. **On the procurement and contracting side, can you also provide us with information regarding the amount and percent of contracts that Treasury makes with small and disadvantaged business enterprises, particularly women and minority owned firms?**

As reported to OMB, Treasury awarded the following to small and disadvantaged business enterprises in FY 2008 (Treasury FY2008 obligations totaled $4340.3 Million).

Small Business: 28.6 percent.
Small and Disadvantaged Businesses: 7.3 percent.

SBA Section 8(a): 5.1 percent.
Service-Disabled Veteran-Owned Small Businesses: 2.1 percent.
Women-Owned Business: 7.1 percent.
Historically Underutilized Business Zones: 1.4 percent.

a. What is the Treasury Department doing to ensure a diversity of companies can compete for any contracts that you offer?

Treasury makes a concerted effort to ensure contracting opportunities are made available to all companies, including small businesses. The Treasury Acquisition Council reviews Treasury's monthly progress in meeting its small business goals and develops strategies to overcome obstacles. In March 2008, the Office of the Procurement Executive issued policy designed to increase Treasury use of Service-Disabled Veteran-Owned Small Businesses and businesses located in Historically Underutilized Business Zones.

Additional efforts include:

1. The Office of Small and Disadvantaged Business Utilization (OSDBU) sponsors monthly vendor outreach sessions, which features pre-arranged appointments with vendors to discuss their capabilities and procurement opportunities within the Department of the Treasury. The OSDBU sponsors two specialized vendor outreach sessions each fiscal year specifically targeting Women-Owned Small Businesses; and a combined session targeting HUBZone and Service-Disabled Veteran-Owned Small Businesses.

2. Annually, we issue a Forecast of Contract Opportunities that is posted on the Treasury website at www.treas.gov/osdbu website. The Forecast is also available in hard copy.

3. The OSDBU staff and Bureau Small Business Specialists participate in local and out-of-town conferences to inform small businesses on "How to do Business with the Department of the Treasury." OSDBU also participates in external procurement conferences, which include all preference groups and specialized groups.

4. The Bureaus also sponsor industry days, targeting specific socio-economic categories or contracts.

5. The OSDBU participates in the monthly U.S. Small Business Administration's District of Columbia District Office's 8(a) Orientation workshops, providing briefings to newly certified

8(a) contractors on "Doing Business with the Department of the Treasury.

6. Treasury's Small Business Specialists review all contracts over $100,000 to ensure that all acquisition strategies include consideration for small businesses.

7. Several of Treasury's Bureaus have implemented employee incentive programs to encourage the use of small businesses in Treasury contracts.

8. The OSDBU works closely with the Small Business Administration's Resident Procurement Center Representative (SBA PCR) to review all acquisitions, especially those over $550,000 ($1 million for construction). The SBA PCRs assist Treasury with ensuring small businesses have a fair opportunity to compete as subcontractors on Treasury contracts.

9. The OSDBU works closely with SBA and the General Services Administration to provide Treasury acquisition personnel with small business training.

Questions from Ranking Member Jerry Lewis:

45. How will the Administration and Treasury make sure the expanded mortgage programs do not exacerbate the financial incentives and lax lending standards that fueled the credit crisis? When approaching the mortgage crisis, how have the Administration and Treasury addressed making sure participants have sufficient "skin in the game" or an interest in the outcome?

First, homes must be owner-occupied principal residences to qualify under the Home Affordable Modification Program (HAMP), so house flippers and speculators will not qualify. The amount of a mortgage eligible for a modification is capped at the GSE conforming loan limit, so million dollar mortgages will not qualify, neither will second homes nor investor properties. Every modification must meet detailed underwriting standards as outlined in the servicer contracts. Income documentation for Home Affordable Refinances will match the standard underwriting requirements for all other types of GSE loans.

In addition, the Making Home Affordable (MHA) program is structured to provide incentives to servicers for modifying loans in a manner consistent with standardized program guidelines that are designed to require sustainable modifications. Right now, servicers generally get reimbursed for the cost of foreclosing but often are not reimbursed for the extensive labor that good modifications require. We are providing incentives for modifications that work over time – the longer a person stays in a modified mortgage, the more the servicer gets paid. Incentive payments are spread over a five-year period to provide incentives for creating modifications that will be sustainable over the long-term. The first incentive payment is not made until a borrower remains current for a trial period of at least three months, and if the modification fails at any point over the five year period, the servicer stops receiving incentive payments.

Also, it is important to note that under our program, lenders are held accountable for previously extending irresponsible loans. Lenders must take the first loss in doing a modification, and the worse their original loan, the bigger the loss they must take in getting the borrower down to 38 percent debt-to-income ratio without any government subsidy.

Finally, Freddie Mac is managing a robust compliance and data reporting system for the Making Home Affordable program. Freddie Mac will conduct both offsite and onsite reviews of servicers' operations. Treasury is planning to institute various substantial penalties for non-compliance; these may include withholding or reducing payments to servicers, requiring repayments of prior payments made to servicers with respect to impacted loans, or requiring additional servicer oversight.

46. **How will the Administration and Treasury address state requests for federal backstops like that made by the Governor of California? California and other distressed states cannot continue pushing difficult budget choices into the future. How can the federal government provide certain states backstops while protecting the interests of taxpayers nationally?**

We recognize that this is not an easy time for California or other states faced with difficult fiscal choices. The Administration is now implementing a Recovery Act that included the largest emergency fiscal relief to state governments in U.S. history. These measures boost economic demand and reduce the pressure on states to cut back on important health and education services in these difficult times.

But as we have made clear, the ultimate solution to California's fiscal challenges lies in California. The Governor and the legislative leaders have all said they are committed to addressing the state's problems, and they have recognized that any real solution must come from California. Clearly, this will require tough budget choices by the leaders of this state and shared sacrifice by all. At the same time, we will, of course, continue to closely monitor the fiscal and economic situation of California and other states across the country.

Questions from Ranking Member Jo Ann Emerson:

47. According to a study by the Congressional Oversight Panel released on February 9th, Treasury paid substantially more for the assets it purchased under the TARP than their market value at the time they were purchased. The report estimates that in 2008 Treasury paid $254 billion but only received assets worth $176 billion. When Congress passed the TARP legislation, we didn't think the funds would be used for making bad investments. We were told that in the long term the Federal government could actually make money on the assets purchased. While you were not at Treasury at the time of these purchases, can you explain why Treasury purchased capital assets below their market value?

We have several concerns with the valuation method that the Congressional Oversight Panel used to value the assets purchased:

- The method used assumes the Qualifying Financial Institutions (QFI) have ready access to the equity markets, an assumption that is not evident in the current market.
- Treasury indicated in December that "**on an accrual basis**, the investments are at or near par." This reflected the fact that we are receiving almost all of our dividends on time.
- Investing in the QFIs through a senior preferred share with a 5 percent dividend allows the banks to lower their cost of capital, enabling them to lend at lower rates.
- The cumulative nature of the preferred provides important flexibility to the QFI which keep the investments from becoming unduly burdensome to the health and/or limiting the QFI's ability to lend.
- The analysis does not take into account the fact that under Federal law, Treasury can change the term of a CPP or TIP contract unilaterally.

We are looking into other valuation methods.

The Capital Purchase Program was essential to preventing a financial collapse. An analysis suggesting taxpayers overpaid ignores the benefit to taxpayers of preventing a financial collapse.

48. Going forward how are you valuing the assets that Treasury purchases? How will you balance the need to make financial institutions healthy versus protecting the taxpayer's investment?

The Office of Financial Stability (OFS) recognizes the need to derive, track and report on the fair market value of the assets in the TARP portfolio as part of its risk analysis and portfolio management functions. To this end, OFS has developed internal market-based valuation models, engaged external pricing vendors through its custodian bank, and selected three asset management firms as financial agents to provide asset management services, including valuation, consistent with Treasury's asset management guidelines. In addition, OFS is currently developing an asset valuation policy intended to address the fair market valuation of TARP assets, to include requirements for reporting fair market values to external sources, such as the public. Related disclosure procedures are also under development.

49. The Administration estimates that your housing plan that was announced in March will help up to 9 million homeowners avoid foreclosure by allowing homeowners that are upside down on their loans to refinance, and by reducing struggling homeowners' monthly payments to 31 percent of their monthly income. How many homeowners have you assisted to date? How many do you believe you will have helped by the end of the year?

- In March, the Administration projected that 3 to 4 million homeowners would be offered assistance under Home Affordable Modification Program (HAMP) between 2009 and 2012. To date, 47 servicers have signed up for HAMP, including the five largest servicers in the U.S. Between loans covered by these servicers and loans owned or guaranteed by the GSEs, more than 86 percent of mortgage loans in the U.S. are now covered by the program. These participating servicers have extended offers on over 570,000 trial modifications and started 360,000 trial modifications. We have set reaching 500,000 trial modification starts by November 1.

- In March, the Administration estimated that 4 or 5 million borrowers were eligible to refinance and would find refinancing to be advantageous under the Home Affordable Refinance Program (HARP). The estimate of the number of homeowners who may find refinancing to be advantageous is highly dependent on interest rates. To date, 90,000 borrowers have refinanced under this program. Since March, the Administration has announced the expansion of HARP up to 125 percent loan-to-value.

- We have developed a consumer-targeted website, www.MakingHomeAffordable.gov, to provide borrowers with information about the MHA program as well as other important information about managing their mortgages. The website is in both Spanish and English, and has had over 24 million page views.

- The interagency team has developed a call center for borrowers to contact HUD approved housing counselors to get additional assistance with their mortgages, both within and outside of the MHA program.

- Fannie Mae and the interagency team are conducting a direct outreach program for struggling borrowers, with planned foreclosure prevention workshops in cities across the country.

50. **When do you think foreclosures will begin to decline?**

The crisis in the housing market was not created overnight and will not be solved easily. As you know, dislocations in the housing and mortgage markets spread through the financial system and the broader economy, and now substantial financial and macroeconomic headwinds are in turn exacerbating problems in the housing and mortgage markets. The Administration has reacted swiftly and aggressively to support both the housing market and the economy more generally. Making Home Affordable is just one facet of the Administration's broader response to these challenges, and its ability to positively impact the housing market will increase as the other aspects of the Administration's plan continue to take effect.

Within weeks of assuming office, the President worked with Congress to enact the largest economic recovery plan since World War II. By the time the plan has been fully implemented by the end of next year, we will have injected nearly $800 billion into the U.S. economy, saved or created 3.5 million jobs and raised our real gross domestic product (GDP) by at least 3 percent.. Meanwhile, the Home Affordable Modification Program – by providing a monthly payment that is less than or equal to 31 percent of a borrower's gross monthly income – will offer an affordable and sustainable solution for struggling borrowers.

We believe that the stimulus measures will reduce macroeconomic headwinds over time and the MHA program will help to reduce the number of foreclosures. The MHA program was developed to continue for three years because we recognize that it will take time for the nation's housing market to recover. At the same time, there have been some limited positive signs that the economy is beginning to mend. In August and September, we have seen some measures of consumer confidence rise to their highest levels since 2007.

We must press ahead with our financial stabilization and our economic recovery efforts, including preventing foreclosures for responsible Americans through rapid implementation of our Making Home Affordable plan.

51. **How will you be able to refinance or modify millions of loans quickly while insuring that people who are unable to afford even a refinanced loan are not approved, people that don't need assistance are not approved, and that speculators, house flippers, and people intentionally running up their debt are not approved for government subsidized refinancing?**

This program is specifically designed to provide responsible owner occupants struggling to make monthly payments on principal residences with affordable and sustainable modified mortgage payments. Homes must be owner occupied principal residences to qualify for the Home Affordable Modification Program (HAMP), so house flippers and speculators will not qualify. Every modification must meet detailed underwriting standards as outlined in the servicer contracts. Income documentation for Home Affordable Refinances will match standard underwriting requirements for all GSE loans. The program's "pay for success" structure only provides incentive payments for modifications that are successful and spreads out incentive payments over a five year period – so the longer a borrower stays in a modified mortgage, the more the servicer gets paid. In addition, borrowers with a back-end debt-to-income (DTI) ratio greater than 55 percent must attend credit counseling in order to qualify for the Making Home Affordable (MHA) program, as an extra protection for borrowers and servicers that anyone approved for the MHA program will be able to afford the monthly payments.

The modification and refinance programs cannot help every borrower. For those borrowers unable to afford even a modified or refinanced payment, our program includes incentives for foreclosure alternatives, including for short-sale and deeds-in-lieu of foreclosure, to help borrowers relocate to housing they can afford.

The MHA program also has a robust compliance and reporting structure managed by Freddie Mac. These compliance and reporting systems have been designed precisely to avoid problems such as the ones you have mentioned. In its role as dedicated compliance manager for the HAMP, Freddie Mac will conduct both offsite and onsite reviews of servicers in order to ensure that servicers are evaluating and modifying loans in full accordance with program guidelines. Treasury is planning to institute various substantial penalties for non-compliance; these may include withholding or reducing payments to servicers, requiring repayments of prior payments made to servicers with respect to impacted loans, or requiring additional servicer oversight.

52. Does this proposal reward banks for modifying loans they shouldn't have made? Are we rewarding bad behavior?

No. The objective of the Making Home Affordable (MHA) program is to facilitate affordable modifications that are sustainable going forward. Our plan leaves lenders on the hook for the loans they made by requiring them to take the first loss in performing a modification; the worse their original loan, the bigger the loss they must take in getting the borrower down to 38 percent debt-to-income without any government subsidy. Importantly, lenders cannot "cherry pick" the loans they modify. Once they have signed the servicer participation agreement, they are required to run a net present value (NPV) test on all loans that meet the program's eligibility criteria, and to offer a modification if the NPV test produces a positive result. Further, the program's incentives only begin to accrue once the borrower has successfully completed a trial period of at least three months at the modified payment level. If a lender performs a modification that does not result in a viable loan, it will not be rewarded with any government incentive payments.

53. **Our current financial regulatory system is outdated and has served investors, financial institutions and the taxpayer very poorly during the current economic crisis. Last year, Treasury Secretary Paulson issued a Blueprint for Modernizing the Financial Regulatory Structure, and the GAO and the Congressional Oversight Panel have suggested there is a need to evaluate system-wide risk across the financial industry. The President has asked the Financial Services and Banking authorizing committees to consider regulatory reform legislation.**

    a. **What are your thoughts on regulatory reform?**

    On June 17, the Treasury outlined a sweeping set of regulatory reforms to lay the foundation for a safer, more stable financial system, one that can deliver the benefits of market-driven financial innovation even as it guards against the dangers of market-driven excesses. Every financial crisis over the last generation has sparked some effort at reform, but past efforts have begun too late, often after the will to act has subsided. We cannot let this happen again.

    Financial regulatory reform is critical and we look forward to working with this committee in the weeks and months ahead to put in place a stronger foundation for a more stable financial system in the future.

    b. **Is creating a super regulatory agency to evaluate system-wide risks necessary?**

    Treasury has not proposed such an agency.

    We are proposing a comprehensive strategy for systemic risk regulation. That strategy includes a Council of regulators charged with identifying emerging risks and coordinating among regulators; a single supervisor for all firms that could pose a threat to financial stability if they failed; enhanced protections for consumers and investors; and a new resolution authority for failing bank holding companies and other nonbank financial institutions.

    For financial institutions, we propose that the Federal Reserve provide consolidated supervision and regulation of any financial firm whose combination of size, leverage, and interconnectedness could pose a threat to financial stability if it failed. The financial crisis has demonstrated the crucial importance of having a consolidated supervisor and regulator for all Tier-1 Financial Holding Companies (FHCs), equipped with a deep understanding of the operations of each firm and charged with the authority and responsibility to regulate these firms, not just to protect their individual safety and soundness but to protect the entire financial system.

For financial markets, our proposal would enhance the responsibilities and authorities of a number of federal agencies to regulate the important financial market activities that contributed to the current financial crisis, including securitization, credit default swaps, and other over-the-counter (OTC) derivatives. We are also creating a Council of regulators with the broad responsibility to identify any threats to financial stability that may emerge from the financial markets.

c. **How does the concept of a super regulator impact free markets and capitalism?**

We are not proposing a super regulator. In some countries, such as the United Kingdom, there is a single, consolidated regulator for all financial institutions – although that model did not prevent the significant impacts of this crisis on their financial system.

d. **How much is too much regulation? How do you determine when the cost to companies and investors of additional regulation is too great compared to its benefits?**

Designing a system that has a proper balance between innovation and efficiency on the one hand and stability and protection on the other is our core challenge. In the years before this crisis, we did not get that balance right, and that requires a substantial reform.

We think the best way to keep the system safe for innovation is to have stronger protections against risk with stronger capital buffers, to have greater disclosure so that investors and consumers can make more informed financial decisions, and to have a system that is better able to evolve as innovation advances in the structure of our financial system changes in the future.

e. **It is obvious that Wall Street has not been able to effectively evaluate systemic risk. Do you think the Federal government will be capable to effectively evaluate systemic risk in our very complex financial system?**

It is difficult, if not impossible, to pin-point systemic risk as it emerges. Treasury has proposed a structure that will task the Financial Services Oversight Council with looking out for emerging risks. However, it is crucial that we establish much stronger cushions in the system, shock absorbers in terms of capital and liquidity, with a better capacity to absorb losses and withstand shocks, so that we are better positioned to deal with potential sources of risk wherever they emerge.

54. Currently, the funding mechanisms for financial regulators vary greatly. For example, CFTC is funded through direct appropriations; the SEC is funded through fees but the fees have to be appropriated to the agency before they can be spent; the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the FDIC are all funded through fees that are not subject to the appropriations process. Some have speculated that certain regulators haven't taken actions against large financial institutions because they didn't want their fee collections to be negatively impacted. Perhaps the SEC model would serve the other regulators well. The industry being regulated is providing funds, reducing the need for discretionary appropriations, but because the fees are appropriated, there is no direct conflict of interest between the regulator and regulated. What are your thoughts on funding regulators?

The funding mechanism for regulatory agencies is important. We have begun a Treasury working group on the supervision of financial firms that will examine how supervisory agencies should be funded and structured, keeping in mind that the funding structure can seriously impact regulatory competition and potentially lead to regulatory capture.

55. Estimates are that over 7,000 people have been murdered in Mexico as a result of the ongoing drug war between cartels and Mexican authorities since January 2008. Spillover violence connected to drug activity has been documented in Georgia, Alabama, and Arizona, not to mention the amount of cocaine, meth, and heroin which enters the United States via Mexico.

a. Can you describe what OFAC, IRS, and FinCen are doing to combat the Mexican drug cartels and laundering of drug proceeds?

Treasury is committed to targeting the illicit financial networks of cartels through financial enforcement measures, providing capacity building technical assistance to enhance Mexico's ability to tackle the threat, and increasing domestic as well as bilateral information sharing capabilities in support of U.S. and Mexican law enforcement.

- **Office of Foreign Assets Control (OFAC)** – Since 2000, OFAC has sanctioned over 250 entities and individuals in Mexico under the Foreign Narcotics Kingpin Designation Act, thereby denying their access to the U.S. financial system, prohibiting them from all trade and transactions with U.S. companies and individuals, and immobilizing any assets they may have under U.S. jurisdiction. In addition to five headquarters investigators, OFAC's Attaché in Mexico City and an investigator detailed to the Southwest Border coordinate closely with an expanded team of investigators whose focus is targeting the illicit financial networks of the Mexican drug cartels.

- **IRS-Criminal Investigations (IRS-CI)** – IRS-CI uses the tax code, money laundering statutes, and asset seizure/forfeiture laws to thoroughly investigate the financial operations of targeted organizations, and to dismantle and disrupt drug-related money laundering. A significant number of IRS-CI investigations in the Southwest Region have links to the major Mexican drug cartels, and IRS-CI's narcotics dedicated resources in field offices along the Southwest border are substantially higher than in non-border field offices. IRS-CI concentrates on identifying and destroying the financial systems that support the drug trade, and on seizing the assets and profits of major criminal organizations, through participation in the Organized Crime Drug Enforcement Task Force (OCDETF), in the High Intensity Drug Trafficking Area (HIDTA) Task Forces, and through its attaché office in Mexico City. IRS-CI also chaired the Money Chapter of the 2009 National Southwest Border Counternarcotics Strategy.

- **Financial Crimes Enforcement Network (FinCEN)** – FinCEN's analysis of cross-border currency flows yields valuable insights into trends and processes, as well as tactical leads, for law enforcement. FinCEN has also engaged in information sharing initiatives with U.S. banks serving Mexico and the Southwest Border region, to gain additional insights into U.S. banknote repatriation and emerging trends. Furthermore, FinCEN collaborates closely with its Mexican counterpart - the Unidad de Inteligencia Financiera (UIF) - to improve tactical and strategic information sharing.

OFAC, IRS-CI, FinCEN, and the Treasury Office of Technical Assistance also provide in-depth, expert training for Mexico's criminal investigators and prosecutors.

b. Are you doing enough in this area? Do you need additional resources?

In response to the concerns raised earlier this year about the increased level of violence in Mexico and along the Southwest Border, including those expressed by President Obama, Treasury immediately took steps to ramp up its ongoing efforts to staunch the financial underpinnings of the Mexican drug trafficking organizations. Such steps include reassigning some portfolios and hiring additional personnel, expanding our already strong interagency partnerships through implementation of the National Money Laundering Strategy and the National Southwest Border Counternarcotics Strategy, and deepening our collaboration with Mexican Finance Ministry and Mexican federal law enforcement counterparts. Additional resources could be put to productive use.

56. The budget proposes a new $80 million user fee on the alcohol industry that would be used to offset the cost of the Alcohol and Tobacco Trade and Tax Bureau.

a. Are you working with Ways and Means or the Energy and Commerce Committees to enact the necessary authorizing language to implement this fee?

b. Do you expect those Committees to mark-up your proposed legislation soon?

c. If those Committees do not advance this proposed user fee, will the Administration submit a budget amendment requesting the $80 million reduction be restored?

The Administration proposed the Tax and Trade Bureau user fees as part of the appropriations bill because the intention is to use the receipts to finance the operations of the bureau. We do not believe that separate authorizing legislation is necessary to implement this fee proposal. If the user fee proposal is not approved, we will work with Congress to determine the next steps.

Questions from Rep. John Culberson:

57. How will the government extricate itself from market intervention? What is our exit strategy for government bailouts?

The Administration's Financial Stability Plan was created to address a severe financial crisis, and its programs are meant to be temporary.

The statutory authority to make new investments expires on December 31, 2009 with the ability to extend that authority to October 3, 2010. As a result, the assistance we provide under this program has a finite timeline.

In each program, we have provided exit mechanisms through (a) increasing the cost of our assistance over time (through contractually increasing the interest rate or leaving flexibility to do so in the future), or (b) providing a fixed term or mandatory amortization period after some time. These mechanisms should encourage institutions to replace our capital with private sources.

58. **Right now, Treasury bonds are viewed as reasonably safe investments relative to other options. And foreign investors are continuing to lend. Do you believe investor confidence will remain strong given the country's rising debt levels? Has your Administration made any efforts, particularly with foreign lenders, to ease concerns regarding our future outlook?**

    The new Administration is committed to fiscal discipline. The U.S. maintains the deepest and most liquid markets in the world and will remain an excellent destination for world investment funds.

59. **On behalf of my constituent Don Hooper, I would like to know your plans should we see debasement of the U.S. dollar?**

    A strong dollar is in our interest. Our policies are targeted to further strengthen the American financial system and the American economy. We have moved aggressively and we are making steady progress.

60. **On behalf of my constituent, Tony Franjie, I would like to know if you are planning for another Treasury capital injection program in 2010-2012 when the next wave of foreclosures and mortgage rate resets hit, with Alt-A and option ARM mortgage resets? We are likely to see new massive losses for banks when these resets hit, so are you planning for TARP-like program to address future bank losses?**

    The government's Supervisory Capital Assessment Program (SCAP), the so-called "stress test", estimated the capital needs for major banks under an adverse economic scenario. In particular, the SCAP estimated losses that those banks are likely to incur through 2010, and the appropriate level of loan loss reserves at the end of that period. Since the stress test results were announced, many major banks have raised a substantial amount of new private capital, reducing the likelihood that the U.S. government will need to inject additional capital.

61. **The Treasury Department recently announced the Legacy Loans Program in an attempt to purge toxic assets. Given that this program is believed to be the riskiest component of the government's financial rescue plan, can you provide details on how the government will ensure that taxpayers are protected?**

    The government's partnering with private capital to facilitate a market mechanism for valuing troubled assets is central to the Legacy Loans Program. If the Treasury were to act alone in directly purchasing legacy loans and other assets, the Treasury, on behalf of the U.S. taxpayers, would risk overpaying for such assets. Since TARP capital will be invested alongside private investor capital on similar terms, the risk of the Treasury overpaying for the legacy assets will be reduced. Further, the Treasury will oversee and manage its equity contributions to better protect taxpayer interests. Creating equity partnerships with private investors should protect the interests of taxpayers over the long-term and help restore liquidity and enable private market price discovery for troubled assets in the short-term.

62. When large banks repay their TARP injections, will you reinvest the funds? Do you intend to hold on to TARP investments beyond 2010? Why have you not taken numerous banks' offers to pay back the Treasury investment?

Repaid funds will be deposited into the general fund for the purpose of deficit reduction, as required by the Emergency Economic Stabilization Act (EESA). These repayments reduce the total amount of outstanding assets and free up headroom under TARP's $700 billion cap. This provides Treasury with additional flexibility to stabilize the economy and build the foundation for long-term economic growth.

To date, 32 banks have repaid Treasury's investment, for a total of approximately $70.1 billion, including $68.3 billion received on June 17, 2009, from ten of the largest banks that participated in the stress test.

The statutory authority to make new investments expires on December 31, 2009, with the ability to extend that authority to October 3, 2010. As a result, the assistance we provide under this program has a finite timeline. With regard to current investments, Treasury is not seeking to be a long-term shareholder. Furthermore, these investments were designed to encourage financial institutions to seek to repay Treasury's investment when the market recovers. In each program, we have provided exit mechanisms through either (a) increasing the cost of our assistance over time (through contractually increasing the interest rate or leaving flexibility to do so in the future) or (b) providing a fixed-term or mandatory amortization period after some time.

63. The Administration's Homeowner Affordability and Stability Plan aims to help up to 4 to 5 million homeowners access refinancing to avoid foreclosure. I am concerned that the overwhelming amount of paperwork to manually process these loans will stunt the process and result in billions in processing costs. How are lenders going to effectively handle refinancing millions of loans in a timely manner without putting an automated process in place? Is Treasury planning to use an electronic processing system with the capability to verify income and to conduct the refinancing through a user-friendly interface? How is Treasury evaluating plans to process loans totally electronically?

Fannie Mae has developed streamlined processing for refinancing and continues to work on further streamlining its processes. Fannie Mae now provides two Refi Plus options for Fannie Mae lenders to provide refinance solutions to eligible borrowers.

As part of the Home Affordable Refinance Program (HARP), Fannie Mae offers two methods to underwrite a HARP loan. One method is through Desktop Underwriter (DU Refi Plus). This automated underwriting system processes the information supplied on the loan application, using a risk-assessment model to produce an underwriting decision. With DU Refi Plus, any lender can originate a refinance of an existing Fannie Mae loan. A second method, Refi Plus, is a manual process limited to the servicer/lender of the original loan.

64. I am concerned by the sharp decline in availability in warehouse lending credit facilities for home mortgage lenders. 85-90% of the warehouse lending capacity has left the market over the past two years. What will be the impact in the housing market if we stimulate demand for mortgages without ensuring adequate funding capacity at the closing tables across the country? Does the Treasury have any plans to provide assistance to this market segment or plans to ask that the GSEs provide assistance? Can we count on the Treasury Department to work with existing warehouse lenders, the federal banking agencies, and the Federal Housing Finance Agency to ensure that the warehouse lending gap does not cut short the housing recovery?

We appreciate the important role that warehouse lenders play as the key conduit in providing financing to GSE and FHA originators during the period prior to funding via the agencies. Lack of sufficient warehouse capacity has the potential to drive mortgage rates higher and limit competition and choice to the borrower.

In June, Treasury hosted a meeting to brainstorm possible public sector and private sector solutions with representatives from FHFA, the GSEs, federal banking regulators, industry trade groups, warehouse lenders, and non-depository mortgage originators. We will continue to work with government and private sector partners to explore possible options for increasing warehouse lending capacity.

65. How are Treasury's actions promoting economic growth and what assurances do we have that our actions will not limit economic growth and further erode future generations' fiscal position?

To reverse the current economic crisis, the Administration has developed programs to keep credit flowing and support jobs and income. The American Recovery and Reinvestment Act of 2009 stimulates the economy and builds the foundation for long-term economic growth with investments in health care, education, infrastructure and energy. As the President has said, the new Administration is committed to a long-term fiscal sustainability.

66. Considering the hundreds of billions of dollars poured into the banking system since October, how have the Treasury's actions helped expand consumer lending?

The Administration's financial policies have supported consumer's access to credit in a number of important ways. First, continued support for the GSE's and the mortgage market more generally has helped to increase originations of residential mortgages in spite of the ongoing problems in the housing and financial sectors. In the first quarter, originations of residential mortgages were up almost 60 percent, compared to the fourth quarter of last year. Second, the Administration's commitment to the Term Asset-backed-securities Loan Facility (TALF) has supported a recovery in the issuance of new securities backed by consumer loans. In recent years asset-backed securities have taken up between one quarter and one third of the increase in consumer credit. In the fall this market was virtually shut down. However, the pace of new issuance of asset-backed securities (ABS), much of it support by the TALF program, has picked up steadily this year and in the most recent month issuance of consumer ABS was almost back to pre-crisis levels.

67. **You have been selecting which companies in American industry and finance will get taxpayer money. What criteria do you use to choose winner and losers?**

Treasury is not picking "winners and losers." All programs are designed to stabilize the financial sector and restore the flow of credit to consumers and businesses. All program guidelines and criteria are available on Treasury's website, as are all investment agreements. This includes guidelines for the Capital Purchase Program (CPP), the Auto Industry Financing Program (AIFP), the Targeted Investment Program (TIP), the Term Asset Backed Lending Facility (TALF) and the Public-Private Investment program (PPIP).

68. **I am concerned that in restructuring General Motors, the Administration is considering favoring the rights and claims of the UAW, over the rights and claims of GM's bondholders. Choosing to favor one set of debt holders' claims over the other equal class of creditors sets a dangerous precedent. Will the Administration treat equal classes of debt-holders fairly and equally during restructuring negotiations?**

It is ordinary course in a Chapter 11 process for some unsecured creditors to receive a greater recovery than others, based on how vital they are to the ongoing commercial viability of the enterprise.

WITNESSES