

U.S. DEPARTMENT OF THE TREASURY

Press Center



Treasury Secretary Timothy F. Geithner Written Testimony Senate Committee on Appropriations Subcommittee on Financial Services and General Government Treasury Budget

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Introduction

Chairman Durbin, Ranking Member Collins, members of the Subcommittee, thank you for the chance to testify about the President's Fiscal Year FY 2011 Budget for the Department of the Treasury.

Treasury plays a critical role in the day-to-day lives of Americans. We disburse Social Security checks, distribute tax credits to stimulate the economy and manage the finances of the United States Government. Under the leadership of President Obama, we have used authority provided by Congress to help responsible homeowners, promote investment in underserved communities, and stimulate lending for the small businesses that create jobs across the country. As we emerge from the worst financial crisis in generations, Treasury's role in both protecting the financial security of Americans and our efforts to stimulate the economy will continue to be essential to the nation's recovery.

Treasury's FY 2011 Budget seeks to invest in four areas: repairing and reforming the financial system to make it safer and help assure that its benefits are broadly shared; boosting voluntary compliance with our tax code to pay for vital government functions; advancing our global economic interests and national security; and rebuilding the Treasury's professional staff.

The focused investments in Treasury's Budget request will support our key goals of furthering efforts to spur job creation and private investment, stabilizing the housing market and financial sector, and reinforcing strong, broad-based economic growth. I look forward to discussing some of the details of our Budget request with you today.

Economic Recovery and Crisis Response

While substantial challenges remain for the economy and financial system, the broad strategy that this Administration has adopted to address a historic recession and contain the financial crisis has been effective.

A year ago, the American economy was shrinking at an annualized rate of more than six percent. The Administration responded with strong policy actions, including the American Recovery and Reinvestment Act ("Recovery Act"), the Financial Stability Plan, and programs aimed at supporting housing markets. The economy began growing in the second half of 2009 and grew nearly six percent at an annual rate in the fourth quarter. The Council of Economic Advisors has compiled a range of private estimates that indicate the Recovery Act has saved or created somewhere between 1.5 million to 1.9 million jobs through the first quarter of 2010.

Because roughly one-third of the overall package consists of tax cuts, Treasury has played a substantial role in the implementation of the Recovery Act. The tax cuts include the Making Work Pay tax credit, which cuts taxes for 95 percent of America's working families, as well as important tax cuts for small businesses. In addition, the tax credits for clean energy and infrastructure in the Recovery Act have led to billions of dollars in targeted investments for these crucial sectors. Finally, Treasury has worked to implement the Build America Bonds program, which has supported over \$90 billion in new financing for state and local governments' capital projects. In a recent report, we note that Build America Bonds have saved state and local governments' more than \$12 billion.

In February of last year, I announced a strategy to stabilize our financial system and encourage banks to raise private capital to replace the Troubled Asset Relief Program (TARP) investment in order to be able to absorb the losses they faced in a severe crisis. The stress tests of our largest financial institutions provided the transparency and confidence necessary for those institutions to raise substantial capital in private markets. Since the results of the stress tests were announced, these institutions have raised over \$150 billion in high-quality capital and over \$75 billion in non-guaranteed unsecured debt. Treasury has already recovered two-thirds of TARP investments in

banks, earning more than \$19 billion on those investments through dividends and warrants. Today, the American government has a dramatically smaller investment in banks than a year ago because of this Administration's policies.

The expected cost of our financial stabilization efforts has also fallen sharply since last year. In President Obama's FY 2010 Budget, as transmitted in May 2009, the projected impact of financial stabilization efforts on the deficit was over \$550 billion, including TARP and a reserve in case of continued instability. Today, the Treasury expects that impact will be less than one percent of GDP. And, if Congress adopts the President's proposed Financial Crisis Responsibility Fee, American taxpayers will not have to pay one penny for the cost of TARP. Treasury will continue its efforts in these areas until recovery is firmly established and the financial system is repaired and reformed.

Treasury's Budget

As the steward of the nation's finances, Treasury is well aware of the fiscal constraints America is facing. As we put together this year's Budget request, we placed a priority on identifying potential savings.

We made a series of tough choices. In some cases, we decided that it was necessary to terminate well-intentioned and sometimes popular programs because they aren't working or are duplicative. In others, we concluded that programs are worthwhile, but only if funding is accompanied by fundamental reform. In still others, we chose to seek your approval to shift the cost of programs from all taxpayers to those who benefit directly from the programs.

In the end, Treasury came up with nearly a half billion dollars in savings and revenues from bureaus and offices throughout the Department. Among the proposals:

- Fund the Alcohol and Tobacco Tax and Trade Bureau (TTB) in the same way as most other regulatory agencies --through fees on the regulated industries--at a savings to taxpayers of \$106 million;
- Save the Community Development Financial Institutions (CDFI) Fund \$105 million by not funding its Capital Magnet Fund and Bank Enterprise Award in the coming year;
- Save the IRS nearly \$23 million through increased e-filing and another \$20 million by eliminating the automatic mailing of tax booklets to taxpayers;
- Save \$10.6 million in the Department's Headquarters Offices budget through efficiencies such as improved technology contracting and space utilization; and
- Cancel \$62 million in unobligated balances from the Treasury Forfeiture Fund.

The result of our efforts is the targeted, constrained Budget that you have before you, a \$13.9 billion request for the Department's 10 appropriated bureaus.

Our Budget request includes a \$474 million, or 3.5 percent, increase over FY 2010 enacted levels. This Budget includes targeted investments in the Internal Revenue Service (IRS), the CDFI Fund, global economic and national security efforts, and institutional capacity.

These key areas of investment in the FY 2011 Budget will be crucial to addressing the challenges our nation faces, and I would like to turn to how each will help us meet our increased responsibilities, achieve our immediate goals, and perform our core missions.

Improving the IRS

The Internal Revenue Service is vital to the financial well-being of the nation. As the government's revenue collector, it raises the money that builds our roads, improves our health, and secures our nation.

Treasury's Budget request for the IRS reflects our understanding that administering a tax code involves not only collecting payments and keeping records, but also increasing compliance with our tax laws.

To increase tax compliance we will bolster international enforcement, regulate tax preparers and improve the services that the IRS provides. To work effectively, all of these will depend on completing a long-running effort to modernize IRS technology.

Our Budget request provides nearly \$250 million for new enforcement initiatives aimed at reducing international tax evasion and noncompliance by businesses and high net worth filers. By the time these measures are fully in place, we estimate that they will produce additional tax revenues of nearly \$2 billion a year. This will mean \$9 in additional revenue for every additional enforcement dollar spent.

The Budget request includes a number of legislative proposals including repeal of a requirement that indebted taxpayers make partial payments before starting negotiations with the IRS over how to handle their past due bills, and getting third parties to report more about payments to businesses. These adjustments would be relatively inexpensive to implement, impose little additional burden on taxpayers, and increase collections by an average of \$2.6 billion a year.

We also are working to begin regulating tax return preparers. Given that the IRS estimates there are between 900,000 and 1.2 million preparers operating in the U.S., with many handling hundreds of individual filers, rules limiting fraud and errors by preparers would have a multiplier effect of improving compliance by millions of taxpayers, and would do so at minimal additional cost.

To get taxpayers to voluntarily comply with our tax laws requires more than tougher enforcement; it requires improved service. The Budget request includes a targeted investment of \$46 million to improve taxpayer services. The IRS now receives more than 100 million service calls a year, so we propose \$21 million to improve the answer rate for the IRS's 1-800 telephone lines.

Additionally, we propose \$25 million to upgrade the agency's website, IRS.gov. This will improve the agency's telephone service levels by encouraging taxpayers to turn to the web for services. It will also work in tandem with a multi-year effort by the IRS to encourage

taxpayers to file electronically. Treasury estimates that e-filings will save the agency almost \$23 million in the coming fiscal year, effectively paying for the new investment in the website.

To improve enforcement and service, the IRS must complete a decade-long upgrade of its technology. That's why our Budget request includes a \$168 million investment to finish a new centralized database that we believe will double the speed of refunds to taxpayers, speed resolution of taxpayer issues, and allow for steadier mailing of tax notices to smooth out service-damaging spikes in telephone call volumes.

Reform and Investment

As we recover from the financial crisis, it is important that we put in place financial reforms that will protect consumers, investors, taxpayers and the entire economy from the risk-taking that produced the financial crisis. The House of Representatives has already passed a strong financial reform package and the Senate is moving strong legislation to the floor, and we look forward to continue our work with Congress to produce a package for the President's signature. But as we work to repair the financial system, it is important that we address the economic needs of the hardest hit communities.

The FY 2011 Budget provides the CDFI Fund with \$250 million for the coming fiscal year. This includes \$140 million for its flagship financial assistance awards to CDFIs, an increase of \$32 million, or 30 percent, from the current fiscal year. This funding level is expected to leverage private sector capital by CDFIs and result in loans, investments, financial services and technical assistance to underserved populations and low-income communities.

This translates into significantly more lending to support small businesses and microenterprises, first time homeowners, and the development and rehabilitation of low-income housing and community facilities, such as charter schools and child care centers.

The CDFI Fund reports that recent award recipients helped finance over 10,000 businesses and over 1,600 commercial real estate properties in 2008. CDFIs also reported that they helped create or maintain over 70,000 full-time jobs in that period. While we have made additional funding available for the CDFI Fund's financial and technical assistance awards to CDFIs, we have also refocused our priorities to support two critical new areas: (1) expanding access to financial products and services through the Bank on USA initiative; and (2) a program that is part of the First Lady's campaign against childhood obesity, the Healthy Food Financing Initiative (HFFI).

In order to make funding available for these initiatives and for the Fund's core financial and technical awards, we propose to save \$105 million by not funding the Capital Magnet Fund or Bank Enterprise Awards programs in FY 2011.

The Bank on USA initiative would help expand access to mainstream financial services to help families avoid predatory lending traps and high fees for check-cashing and other alternative financial services. The initiative will promote broader access to bank accounts, basic credit products, and other financial services to help these families build savings and solid credit histories.

HFFI is a partnership between Treasury, the Department of Agriculture, and the Department of Health and Human Services that will provide over \$400 million in financial assistance to expand access to nutritious foods in urban and rural communities that have limited access to healthy foods. The Budget includes an additional \$25 million in grant funding through the CDFI Fund and \$250 million of New Markets Tax Credit (NMTC) authority for HFFI. This initiative will help to promote a range of financing to expand access to nutritious foods, including developing grocery stores and other small businesses selling healthy options in communities where healthy foods are not readily available.

As noted, a key component of HFFI is the New Markets Tax Credit program. The NMTC is another critical tool administered by the CDFI Fund which helps extend the benefits of recovery to hard-hit communities. This tax credit helps attract investment to these communities by reducing the risks investors must take in putting their capital into them. It does so by letting investors claim a 39 percent credit against their federal income taxes in return for making equity investments in Treasury-certified Community Development Entities (CDEs). CDEs, in turn, invest in small businesses and other projects that serve hard-hit communities.

To date, NMTC recipients have invested over \$15.6 billion in distressed communities across the country. That financing has helped small businesses, manufacturers, grocery stores and retail centers, alternative energy projects, healthcare centers, charter schools and job-training sites. It has helped create, save or support hundreds of thousands of local jobs.

The Budget requests \$5 billion in NMTC authority in 2010, and another \$5 billion of authority in 2011, of which \$250 million will be used to expand financing for the development of healthy food retailers as part of HFFI.

We are proposing reforms to make the credit more effective, such as expanding the types of taxes against which the credit can be used. As is the case for many types of investments, investor capacity to use NMTCs has fallen since the recent crisis. To help attract a broader array of investors, our Budget Request would change the credit so that it can be used to offset not only investors' regular federal income taxes, but also the taxes they owe under the Alternative Minimum Tax.

In addition, Treasury is working to simplify rules for the NMTC to improve the overall attractiveness and effectiveness of the credit as well as to make the credit work better for small businesses. Treasury and the IRS are actively pursuing reforms that would make it easier for CDEs to provide more working capital loans and other investments in small businesses in distressed communities. In all of these efforts, our aim is to strengthen the NMTC's ability to attract investments and jobs to hard hit communities.

Global Economic Interest and National Security

Treasury also advances U.S. economic interests abroad, advocates international policies that help create American jobs and domestic economic growth, and protects against foreign threats to our economic and financial well-being. The recent crisis elevated the importance of these tasks.

The Budget provides \$44.4 million to support the Office of International Affairs. This includes a \$6.7 million increase to support our international coordination efforts in forums like the G-20. Although not directly under the jurisdiction of this Subcommittee, the Treasury's Budget request includes approximately \$3 billion to meet our obligations to the International Financial Institutions, which support the President's recent commitments in Copenhagen to help combat climate change, contribute to a multi-donor trust fund to combat global hunger, and meet our international obligations.

Treasury plays a critical role in protecting our national security through the Office of Terrorism and Financial Intelligence (TFI). The Budget provides \$203.1 million for TFI, which includes the Financial Crimes Enforcement Network (FinCEN). This includes \$4.7 million in new investments to improve TFI's ability to target proliferation networks and expand Treasury's role in coordinating financial intelligence across the nation's overall intelligence community. TFI works to deprive proliferators, terrorists, narcotics traffickers, corrupt foreign officials and other illicit actors of the money and financial access they need to carry out or profit from their activities.

To do this, TFI uses financial information to map out the support networks of these dangerous actors, works to educate financial institutions worldwide about the risks of doing business with them, administers and enforces financial regulatory authorities that protect the integrity of our financial system, and collaborates with our foreign partners to set standards to help the international financial system avoid illicit activity.

For example, TFI's efforts to crack down on the financing of the proliferation of weapons of mass destruction have led to financial institutions worldwide cutting off the banks, companies, and individuals that are integral to Iranian, North Korean and Syrian nuclear ambitions. In the case of Iran, all U.S. banks, nearly every major European bank, as well as large banks in Asia and the Middle East, have cut or severely limited their ties to that country.

TFI's efforts have also helped to put Al-Qaida in its worst financial position in years. Its core leadership is struggling to raise and sustain funds.

In pursuing all of these efforts, protecting the integrity of our own financial system is key. That is why, even as we continue our international efforts, Treasury is marshaling state, federal and private sector resources to crack down on mortgage fraud and loan modification scams, and is working to address emerging threats and vulnerabilities in new technologies and financial products.

Rebuilding Treasury's Institutional Capacity

Treasury entered the recent financial and economic crisis with the professional ranks of many of its key policy offices seriously depleted. Responding to the crisis has put a severe strain on these units and made clear the need to rebuild our professional ranks to assure that Treasury can deal effectively with the issues that it must tackle.

We entered the worst economic downturn in generations with only 25 economists working in the Office of Economic Policy, a third fewer than in 2000. To put this in some perspective, the comparable office in the Department of Housing and Urban Development has 140 economists, the Department of Agriculture has 330 economists, and the Federal Reserve System has over 500 economists.

We arrived on the doorstep of the worst financial crisis since the Great Depression with our Financial Markets and Financial Institutions units within Domestic Finance each staffed by about 20 people, and a Tax Policy office whose staff had dropped by one fourth since 2000.

Treasury has a tradition of operating with a lean staff. We are proud of this fact, and have no intention to change it, especially given the severe fiscal constraints that the nation faces. But we must reverse the erosion of the Treasury's basic intellectual capital or we will be unable to meet the nation's economic challenges. We began the process of making targeted investments in upgrading professional staff this fiscal year, and we need to continue it in the coming year.

Our Budget request for FY 2011 would provide the Office of Domestic Finance with an additional \$16.7 million to expand its staff by 24, in order to build capacity to more effectively respond to the aftermath of the financial crisis; promote stronger, more equitable financial policies; and add expertise in securities market structure and housing finance.

The request also provides an enhancement of \$2.4 million to the Office of Tax Policy to hire additional specialists to analyze emerging tax issues and provide timely analysis of key fiscal and financial issues.

Finally, we propose \$2 million in funding to hire additional economists for the Office of Economic Policy for swifter, more effective analysis of economic trends and proposals. This sum would also fund the creation of a data analysis unit to maintain the large economic and financial databases used for Department-wide analyses.

These investments are very modest. We propose to add only six new economists to our Office of Economic Policy, which would still leave its professional staff below where it was in 2000. We propose to add just eight new specialists to the Office of Tax Policy, which would also

leave its professional staff below 2000 levels.

Let me end where I did last year, with a word about the Treasury's staff.

I have had the honor over the past year of leading a team of smart, dedicated individuals who are working to make our government more effective and our society fairer. They debate policies on their merits; they do what is right and not simply what is expedient; and they draw from the best ideas and expertise available. They are performing an incalculable service to our country. In February, I joined IRS Commissioner Shulman in Austin, Texas, to talk to the IRS employees who were affected by the senseless attack on them and their co-workers, like Vernon Hunter, who tragically lost his life in the attack. They are a group of dedicated and committed public servants. This nation owes them a debt of gratitude, and we owe them our respect.

Treasury has accomplished great things in the past year, but we recognize that challenges still lie ahead. The targeted investments proposed in this Budget will provide the tools needed to meet those demands.

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