FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2008

WEDNESDAY, MARCH 28, 2007

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 3:58 p.m., in room SD–192, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin and Allard.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY

STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. This meeting of the Senate Appropriations Subcommittee on Financial Services and General Government will come to order.

We continue our budget hearings today with the Department of the Treasury. We welcome Secretary Henry Paulson to the hearing, along with his associates and my colleagues, who will be joining me, I'm sure, after the rollcall vote. I apologize for the delay in beginning, but we scheduled rollcalls and it changed our timing.

This is a budget hearing for the Treasury Department. We'll defer most of the questions pertaining to the Internal Revenue Service (IRS) until April 18, when Commissioner Everson will appear. The IRS represents 90 percent of the Treasury budget, in terms of actual dollars; the remaining 10 percent contains some very critical activities and programs, which we'll talk about today.

I was pleased, during consideration of the recent continuing resolution, we were able to provide some additional funds for the Department. We do have a budget request for next fiscal year from the Treasury, of about $12.140 billion, an increase of $514 million, or 4.4 percent. Excluding the IRS, the request for the remainder of the Department is $1.45 billion, a net increase of $16 million over the last fiscal year, or 1.5 percent. This appears, at first glance, to be a very tight budget for the Treasury Department.

I have a number of areas of concern, which I will save for the question period. It is now my pleasure to welcome the Secretary to the hearing.

Mr. Secretary, the floor is yours.

STATEMENT OF HENRY M. PAULSON, JR.

Secretary PAULSON. Mr. Chairman, thank you very much.

I've submitted a longer statement for the record. I had a shorter statement that I was going to read, and I just think, in the interest of brevity, what I'll do is, I'll just read two paragraphs of the shorter statement and submit that for the record also, because, as you know, and as you've said, Treasury has a broad and important role in maintaining the economic and national security of this Nation and ensuring the effective operation of the Government, and I'm continually impressed with the caliber of professionalism of Treasury's employees, particularly the career staff, who carry out this work every day.

Now, we have established four priorities in this budget for next year: maintaining the growth and competitiveness of the U.S. economy for the benefit of all our workers and families; investing in tax enforcement and taxpayer services, because it is important that individuals and business pay what they owe; promoting strong economic ties and balanced trade relationships with foreign nations, including China; and continuing our important contribution to the war on terror by choking off terrorist financing and other illicit activities.

PREPARED STATEMENT

Senator DURBIN. Without objection, your entire statement will be made part of the record.

Secretary PAULSON. Good.

[The statement follows:]

PREPARED STATEMENT OF HENRY M. PAULSON, JR.

Chairman Durbin, Senator Brownback, and members of the subcommittee. Thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2008 Budget for the Department of the Treasury.

I am pleased to be here today to provide an overview of the President's Budget for Treasury in fiscal year 2008. The President's Fiscal Year 2008 Budget reflects the Department's budget priorities and dedication to promoting economic growth and opportunity, strengthening national security, and exercising fiscal discipline.

The $12.1 billion request focuses resources on key programs necessary to promote economic growth, fund the activities of the Federal Government and effectively fight the war on terror. The request is $523 million above the amount provided by the fiscal year 2007 funding level, a 4.5 percent increase. By collecting the revenue due to the Federal Government and working to reduce illicit threats to the financial system, the Department of the Treasury contributes to the financial integrity of the United States.

Treasury has a primary role as steward of the U.S. economic and financial systems, including the role of the United States as an influential participant in the international economy. Treasury promotes financial and economic growth at home and abroad. Treasury also performs a critical and far-reaching role in national security. The Department battles national security threats by coordinating financial intelligence, targeting and imposing sanctions on supporters of terrorism, narcotics traffickers, and proliferators of weapons of mass destruction, improving the safeguards of our financial systems, and promoting international relationships to combat the financial underpinnings of terrorist and other criminal networks.

Managing these complex tasks requires expanded capabilities. Fully funding the President's Fiscal Year 2008 Budget request will allow the Treasury Department to continue and improve its ability to study, recommend, and support initiatives that strengthen the U.S. economy, create more jobs for Americans, and enhance citizens' economic security. The Department will actively work to protect the security of pensions, reform Social Security, and improve the Federal income tax system by providing timely, usable, and comprehensive analyses that advance the policy process.

PROMOTING ECONOMIC GROWTH, SECURITY AND OPPORTUNITY

The Treasury Department works diligently to fulfill its role as the administration's chief economic advisor. We strive to provide the President with the best information available on a broad range of domestic and international economic issues. Treasury's Offices of International Affairs, Tax Policy, Economic Policy, and Domestic Finance support this role through the provision of technical analysis, economic forecasting, and policy guidance on issues ranging from federal financing to responding to international financial crises. The Treasury Department supports policies that stimulate U.S. economic growth, strengthen and modernize entitlement programs, and minimize regulatory burdens while ensuring the safety and soundness of financial institutions.

The fiscal year 2008 budget request funds Treasury's efforts to promote domestic and international economic growth through financial diplomacy. Treasury stimulates economic growth and job creation by working to open trade and investment, encouraging growth in developing countries, and promoting responsible policies regarding international debt, finance, and economics. Treasury supports trade liberalization and budget discipline through its role in negotiating and implementing international agreements pertaining to export subsidies. These agreements open markets, level the playing field for U.S. exporters, and provide effective subsidy reductions that save the U.S. taxpayer millions of dollars annually. Since 1991, cumulative budget savings from these arrangements are estimated at over $10 billion. The growth of these activities makes it necessary to enhance policy coordination and resources through the addition of regional experts. Treasury's fiscal year 2008 budget request provides additional staff to support key policy dialogues around the globe. These experts will enhance policy coordination on international matters and will support key policy dialogues with priority countries like China.

Treasury also remains committed to protecting the homeland from international investments that may threaten our national security. The Committee on Foreign Investment in the United States (CFIUS) is an interagency group responsible for investigating the national security implications of the merger or acquisition of U.S. companies by foreign persons. One of my key responsibilities as Secretary is to chair this committee, and to make sure that the interagency CFIUS process performs as efficiently as possible. As foreign investment in the United States has increased, so has the number of cases reviewed by CFIUS. As a result, the fiscal year 2008 budget request provides additional resources to support Treasury's investigations of foreign investments.

The President's fiscal year 2008 request for Treasury also includes $28.6 million for the Community Development Financial Institutions (CDFI) fund. CDFI fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States. In order to ensure that the CDFI program continues to operate in the most efficient and effective manner, Treasury is proposing to phase out the CDFI Bank Enterprise Awards (BEA) program in 2008. There is no evidence that the BEA program improves economic development, and we believe that the program's goals are better served through other CDFI fund activities.

STRENGTHENING NATIONAL SECURITY

The sponsorship of terrorism and potential acquisition of weapons of mass destruction (WMD) by rogue regimes and non-state entities represent grave threats to U.S. national security and the security of all free and open societies. Terrorists, WMD proliferators and other non-state threats require support networks through which money and material flow. The Treasury Department draws on financial and other all-source intelligence, and also works to utilize its unique regulatory and law enforcement authorities, to combat national security threats and safeguard the financial system.

The Department's Office of Terrorism and Financial Intelligence (TFI) provides financial intelligence analysis, develops and implements systems to combat money laundering and terrorist financing, administers the Bank Secrecy Act, and administers and enforces the U.S. Government's economic sanctions programs.

Treasury exercises a full range of intelligence, regulatory, policy, and enforcement tools in tracking and disrupting terrorists' support networks, proliferators of weapons of mass destruction, rogue regimes, and international narco-traffickers, both as a vital source of intelligence and as a means of degrading their ability to function. Treasury's actions include:

—Freezing the assets of terrorists, proliferators, drug kingpins, and other criminals and shutting down the channels through which they raise and move money;
—cutting off corrupt foreign jurisdictions and financial institutions from the U.S. financial system;
—developing and enforcing regulations to reduce terrorist financing and money laundering;
—tracing and repatriating assets looted by corrupt foreign officials; and
—promoting a meaningful exchange of information with the private financial sector to help detect and address threats to the financial system.

The fiscal year 2008 President's Budget will enable Treasury to enhance these capabilities. Treasury requests funding for investments to further the Department's national security mission in three critical areas. First, this budget, if enacted, will enable Treasury to expand its capacity to identify potential national security threats and to enforce U.S. policies to counter those threats. Next, Treasury will enhance the information technology and physical infrastructure of TFI and its component bureaus and offices to improve data security, access, and quality. Finally, the budget would provide funds to help integrate TFI's Office of Intelligence Analysis into the broader intelligence community.

Specifically, this request includes an additional $5.3 million to respond to emerging national security threats, provide strategic policy coordination in regions key to the fight against terrorist financing, and to enhance implementation of sanctions against state sponsors of terrorism and WMD proliferation. The request also includes $8.1 million for infrastructure and information technology projects to enhance data access, security, and quality, including construction of a Sensitive, Compartmented Information Facility (SCIF), stabilization and maintenance of the Treasury Foreign Intelligence Network, and the Critical Infrastructure Protection program. Finally, $1 million is requested for initiatives to further Treasury's integration into the broader intelligence community.

The Financial Crimes Enforcement Network (FinCEN) is responsible for administering the Bank Secrecy Act (BSA). The fiscal year 2008 budget request provides funding to strengthen recovery capability for mission-critical information technology systems and emergency operation capabilities; and improve information technology planning and oversight.

MANAGING U.S. GOVERNMENT FINANCES

The Treasury Department manages the Nation's finances by collecting money due the United States, making its payments, managing its borrowing, investing when appropriate, and performing central accounting functions. Key priorities in managing the government's finances include maximizing voluntary compliance with tax laws and regulations, continually improving financial management processes, and financing the government at the lowest possible cost over time. The fiscal year 2008 budget request provides the funding necessary to properly administer these functions.

Collecting Taxes

Collecting taxes in a fair and consistent manner is a core mission of the Treasury Department. Treasury's priorities in tax administration are enforcing the Nation's tax laws fairly and efficiently while balancing taxpayer service and education to promote voluntary compliance and reduce taxpayer burden. In an effort to maximize tax compliance, the fiscal year 2008 budget includes $11.1 billion for the IRS, which is an increase of $498 million above the amount provided in the fiscal year 2007 funding levels.

The fiscal year 2008 budget request provides funding to enhance coverage of high-risk compliance areas, as well as to address the tax gap, which represents the annual difference between taxes owed and taxes collected, including a multi-year research effort that will provide continuous feedback on noncompliance. Enforcement will focus on critical reporting, filing, and payment compliance programs, and highlight abusive tax avoidance transactions and high income individual examinations involving pass-through entities (e.g., partnerships and trusts). The IRS will also continue to reengineer its examination and collection procedures to reduce audit time, increase yield, and expand coverage. As in fiscal year 2006 and fiscal year 2007, the administration proposes to include IRS enforcement increases as a Budget Enforcement Act program integrity cap adjustment.

The IRS will continue efforts to improve services offered to taxpayers, primarily focusing on those outside of traditional telephone access. For example, the fiscal year 2008 request provides funding to expand the Volunteer Income Tax Assistance program. The IRS will also implement the Taxpayer Assistance Blueprint, a 5 year strategic plan to deliver taxpayer service; a collaborative effort of the IRS, the IRS Oversight Board, and the National Taxpayer Advocate.

Finally, the fiscal year 2008 request will allow the IRS to make critical IT infrastructure upgrades. IRS will continue to invest in technology, process improvements, and training to achieve consistent quality service with reduced costs. The budget also includes funding for the IRS's Business Systems Modernization program, which is designed to provide IRS employees the tools they need to continue to administer and improve both service and enforcement programs.

The President's budget also includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. Once implemented, it is estimated that proposals will generate $29 billion over 10 years. These proposals are presented in detail in the fiscal year 2008 Department of the Treasury Blue Book. The legislative proposals fall into four categories: expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Treasury's Alcohol and Tobacco Tax and Trade Bureau also collects excise taxes on alcohol, tobacco, firearms, and ammunition. In fiscal year 2006, the bureau collected $14.8 billion in excise taxes, interest, and other revenues on these products and also regulates the manufacture of alcohol and tobacco products.

Ensuring Efficient Fiscal Service Operations

The fiscal year 2008 budget request provides the funds necessary for Treasury to meet its responsibilities as the Federal Government's financial manager.

Treasury's management of the Federal Government's finances includes making payments, collecting revenue, preparing public financial statements and collecting delinquent debt owed to the Federal Government through the Financial Management Service (FMS). Treasury oversees a daily cash flow in excess of $58 billion and disburses 85 percent of all federal payments. The Department is working to improve its payments and collections processes by moving toward an all-electronic Treasury. In fiscal year 2006, Treasury issued 742 million electronic payments including income tax refunds, Social Security benefits, and veterans' benefits. Treasury is also encouraging Social Security and Supplemental Security Income recipients to switch to Direct Deposit through the Go Direct campaign. Direct deposit represents a cost savings to the Federal Government, and consequently to the American taxpayer, of 80 cents per transaction compared to a check payment.

Treasury's Bureau of the Public Debt manages all of the public debt, which includes marketable securities, savings bonds, and other instruments held by State and local governments, federal agencies, foreign governments, corporations, and individuals. To improve debt management and offer better customer service, Treasury offers TreasuryDirect, an electronic, web-based system that electronically issues securities to retail customers and enables investors to manage their accounts on-line.

The budget also includes three legislative proposals for FMS that are estimated to save the Federal Government over $3 billion over 10 years. These proposals will allow the government to trace and recover federal payments sent electronically to the wrong account, eliminate the 10-year limitation on the collection of delinquent non-tax federal debts, and remove the disincentive for the IRS to refer tax debts to FMS for collection.

STRENGTHENING FINANCIAL INSTITUTIONS

One of the principal objectives of the Treasury Department is to enable commerce. The Department is responsible for the safety and soundness of national banks and federally-chartered savings associations. The Treasury Department also produces the coins and currency needed for commerce, and guards against counterfeiting and other misuse of our money. While the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the U.S. Mint (Mint), and the Bureau of Engraving and Printing (BEP) are funded through direct annual appropriations, their contribution to Treasury's mission cannot be understated.

Treasury, through OCC and OTS, maintains the integrity of the financial system of the United States by chartering, regulating, and supervising national banks and savings associations. In fiscal year 2006, OCC and OTS oversaw financial assets held by these financial institutions totaling $8.1 trillion.

The Mint and BEP are responsible for producing the Nation's coins and currency, respectively. In fiscal year 2006, the Mint and BEP produced 16.2 billion coins and 8.2 billion paper currency notes, respectively. The Mint issued five new quarters for the 50 State Quarters program and BEP introduced the new $10 currency note into circulation. Also, despite significant increases in the price of metals, the Mint was able to return $750 million to the Treasury General Fund in fiscal year 2006.

Managing Treasury Effectively

Treasury is committed to using the resources provided by taxpayers in the most efficient manner possible. The Department will drive improved results through decision-making that considers performance and cost. The Treasury Department strives to serve its stakeholders in the most effective way while working to leverage resources across the Department and across government.

Funding requested in Treasury's departmental offices and Department-wide Systems and Capital Investments Program (DSCIP) is sought for building a strong information technology infrastructure, ensuring that Treasury remains a world-class organization that meets the President's standard of a citizen-centered, results-oriented government.

The DSCIP account funds technology investments to modernize business processes throughout Treasury, helping the Department improve efficiency. In fiscal year 2008, Treasury requests $18.71 million for ongoing modernization and critical information technology infrastructure projects, and for investment in other new technologies that will improve efficiency and service to the American people. The budget request includes:

—$6 million to begin work on a Treasury-wide Enterprise Content Management System. The initial system will meet the business requirements of the Office of Foreign Assets Control and the Financial Crimes Enforcement Network;

—$2 million for the continued stabilization of the Treasury Secure Data Network; and

—$4 million to improve Treasury's FISMA performance, strengthen the Department's overall security posture, leveraging the President's management agenda, including the E–Government initiatives, across the Department.

This budget request also includes funding for the Office of the Inspector General and the Treasury Inspector General for Tax Administration. These offices play important oversight roles in the overall management of the Department and the fair administration of the Nation's tax laws.

CONCLUSION

Mr. Chairman, thank you again for the opportunity to come here today to discuss with you and the committee the President's Fiscal Year 2008 Budget request for Treasury. I look forward to working with you and the members of the committee in ensuring that Treasury maximizes its resources and funding so that the American people can be assured that their tax dollars are being used in the most effective way possible. I would be more than happy to answer any questions.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS PROGRAM

Senator DURBIN. Let me zero in on a few issues that I think I'd like to raise.

The first relates to the community development financial institutions (CDFI). Since its inception, CDFI has sought to increase the availability of credit, investment capital, and financial services to relatively poor urban and rural communities. The fund pursues these objectives by augmenting the private resources for investment in economic development, housing, banking services. It works with two sets of partners in boosting such investment: private financial institutions, certified by the CDFI as community development financial institutions, and private equity groups.

Now, the administration's budget request includes a request for $28.5 million for this CDFI fund. This is an improvement over last year's budget request, but it is a reduction of nearly 50 percent from the fiscal year 2007 amount of $54.5 million. And $12.2 million of your fiscal 2008 request consists of administrative costs which are necessary, but really don't provide the capital that we're talking about for these institutions.

I'd like to ask you—and I'm going to give you just an illustration of why I think this needs to be discussed. According to the Treasury's own calculations, every dollar the Federal Government invests in the CDFI funds leads to another $27 in non-Federal fund investment. So, meeting the CDFI community request of $100 million, instead of the Treasury Department request of $28.5 million, would cost the Government only an additional $71.5 million, but would provide needy communities over $1.9 billion. That's based on the Treasury's calculations.

Based on the data provided by the Opportunity Finance Network, which advocates on behalf of CDFIs, and on calculations made by my staff, here's the difference that $1.9 billion into inner-cities, rural communities, and Native American reservations would mean: 28,000 jobs, 6,000 new businesses, 64,000 extra housing units, and 1,000 new or improved community facility projects. Isn't that worth $71 million?

Secretary PAULSON. Mr. Chairman, first of all, thanks for your question. Second, this is a good program, so we're not debating this. As you've pointed out, we increased our request this year, and did it meaningfully, although below the funded level. It's something I've looked at carefully, myself. We'd be happy to work with you on this. We have a few differences, maybe, on which parts are the most valuable parts of the program. And so, we can talk about that. But I agree with your basic assertion that this is a good program.

Senator DURBIN. I'm going to get into this a little more with you directly in conversation——

Secretary PAULSON. Sure.

Senator DURBIN [continuing]. To talk about this, because I think I've made a point for the record, and you've——

Secretary PAULSON. We would like——

Senator DURBIN [continuing]. Left an opening for further discussion.

Secretary PAULSON. And we'll work with you—we've got someone new that's running this. I'd be happy to send her up to work with——

Senator DURBIN. Good.

Secretary PAULSON [continuing]. Your staff, and would be happy to get involved, myself.

INFORMATION TECHNOLOGY MANAGEMENT

Senator DURBIN. Thank you.

The inspector general, in his October 16, 2006, memorandum to you concerning management and performance challenges facing the Department, indicated that the Department has difficulties in managing large acquisitions of mission-critical systems and other capital investments. What changes have you made to improve your performance in managing the Department's information technology (IT) projects? Why will this year be better?

Secretary PAULSON. Well, let me say, the report happens to be right, that there are problems, and there have been problems. And it's not easy to correct them all at once. I would say part of them relate to having the right people in the right jobs. We're looking for a new Assistant Secretary of Management, and I think we're close to announcing something there. We're also looking for a new CIO for the Department. And getting those people in place, when we find them, will be important. But it also takes, I think, an integrated approach to this. Bureau heads and key managers have to also buy into this and recognize that managing the IT programs has got to be part of their day-to-day business. It takes training, and we've instituted a number of things in the training area. So, I would say I've been here 8 months; before I came, I had Senator Bond take me aside and tell me there were problems. And he was right.

Senator DURBIN. Since you've been here 8 months, and you come from some of the highest levels of the private sector, it—I don't have that same life experience that you've had. I continue to be puzzled, in Federal agency after Federal agency, why they have such a difficult time with information technology. Does the private sector go through the same pain?

Secretary PAULSON. Well, I would say this. In the private sector, I don't believe I knew a CEO that said, "I'm really happy with my IT. I know that I'm spending all the money properly, that we're getting and doing everything we should, that it's working as well as it should." And I know, in the company I came from, we felt a big part of it. The IT professionals, the CIOs, were important, but every manager had to take responsibility for it, and it couldn't be something separate, it had to be part of their business. I know it is difficult in the private sector when you can offer a lot of money. I know people work for a lot of things, and one of the things I've learned since coming here is how hard people work, how Treasury's got great people and great career people, and the people that are filling in, in these jobs right now, are doing a good job. But it is not easy to find people who are really qualified. And then, the change of culture to make it work isn't easy. But I think the Government overall has problems, and to the best of my judgment, maybe Treasury has a few more problems than some other areas, but I haven't been in some of the other areas. But we're on top of them, and we're doing everything we can. And I think we're making some progress.

BANK SECRECY ACT DIRECT

Senator DURBIN. Let me move to another issue. In June 2004, Treasury established the Bank Secrecy Act (BSA) Direct Retrieval and Sharing Program. This program was designed to make it easier for law enforcement to access and analyze BSA data and to improve our overall data management.

Secretary PAULSON. Right.

Senator DURBIN. On July 13, 2006, the Financial Crimes Enforcement Network (FinCEN) halted the program due to problems with its main contractor. Robert Werner, then director of the program, testified, in September, that the Financial Crimes Enforcement Network is initiating a replanning effort, in his words, for the retrieval and sharing component of the Bank Secrecy Act Direct. Where does this stand, at this point? Tell me about your efforts to improve the sharing of BSA data between Treasury and law enforcement.

Secretary PAULSON. Well, I think we're making progress. But, again, this is in some ways, the same answer to the question that I gave that—in other words, our IT and technology programs throughout Treasury had issues and weren't up to snuff. We've got this up and going. I think we're making progress, in terms of sharing information. I think it's working pretty well. But I'm not going to tell you that we didn't have systems problems.

Senator DURBIN. This predates your arrival.

Secretary PAULSON. Right.

Senator DURBIN. This has been an ongoing issue for 4 years. And we have tried to, with Director Mueller, at the Federal Bureau of Investigation (FBI), and so many other agencies, Homeland Security. I really, kind of, focused on a theme, because I couldn't execute it with any personal knowledge, but the theme was to upgrade information technology and the opportunities for sharing information when it came to security and law enforcement. And what you've just said—I'm not surprised, but it's the same thing that's been said before. And I hope that your expertise in the private sector will help break through some of these problems.

Secretary PAULSON. We're making progress. I would say this. I gave you the negative. The positive is, if I've been surprised on anything on the upside, it's been the quality of the professionals—career professionals who we have at Treasury that are doing this job. And the work that gets done is first-class work, even when we don't have the best systems. And we're approaching this, and we're determined to make some progress here.

TREASURY FOREIGN INTELLIGENCE NETWORK

Senator DURBIN. I believe you've identified the Treasury Foreign Intelligence Network as your top IT development priority. What's the current status of that system?

Secretary PAULSON. I think we're back on track. It's operating. Again, with any of these systems, I'm not going to tell you, with 100 percent certainty, until we get our new Assistant Secretary of Management, and our new CIO in place, but we've done a bit more work——

Senator DURBIN. What is the timetable for filling those spots?

Secretary PAULSON. Soon. I think we're weeks away, knock on wood, from being able to get an Assistant Secretary of Management in place, and I think it may take a little bit longer on the CIO.

TERRORIST FINANCING

Senator DURBIN. One of your critical responsibilities relates to terrorism and financing of terrorism, in the Office of Terrorism and Financial Intelligence (TFI). They seek to integrate the operations and resources of the Office of Terrorist Financing and Financial Crime, the Office of Foreign Assets Control, the Financial Crimes Enforcement Network, and others. Two basic responsibilities of TFI, gather and evaluate financial intelligence, and, two, enforce various financial laws and regulations relative to that intelligence. What do you see as some of the major challenges facing the Office of Terrorism and Financial Intelligence?

Secretary PAULSON. First of all, this is a very important area, and we've got first-class people. Part of what we ask for in our budget is money to build the new SCIF, and to hire and train additional people, because we've got first-rate individuals that work very hard, so that is obviously part of it. The team, I believe, works quite well with others in the intelligence community and, in a number of programs, we play a support role, working with colleagues at State or elsewhere. I think the teamwork is good there. But this area, like anything else, comes down to having the right people in the right jobs, and asking—are they trained well? And are they thinking creatively? And are they working as part of a team? You're talking about an area that I think is as well managed as any area at Treasury, with first-rate professionals.

Senator DURBIN. Mr. Secretary—before I turn it over to my colleague Senator Allard—there's an article in yesterday's Washington Post; it spoke of private business, such as rental and mortgage companies, car dealers, checking the names of customers against a list of suspected terrorists and drug traffickers, made publicly available by the Treasury Department, sometimes denying services to ordinary people whose names are similar to those on the list. The Office of Foreign Asset Control (OFAC) list of specially designated nationals has long been used by banks and other financial institutions to block financial transactions of drug dealers and other criminals, but an Executive order issued by President Bush after the September 11 tragedy has expanded the list and its consequences in unforeseen ways. Businesses have used it to screen applicants for home and car loans, apartments, and even exercise equipment, according to interviews in a report by the Lawyers Committee for Civil Rights of the San Francisco Bay area. To what extent is this list put out by the Office of Foreign Asset Control creating problems for average consumers in this country?

Secretary PAULSON. That's a very good question, and it's something we've talked about and had a number of meetings about. Clearly, these activities that we have to disrupt terrorist financing, to deal with weapons proliferation, and to deal with other illicit activities, are very important. So, we're very careful, in terms of when we publish the list, to get the name right and to have the birth date. And then, what you're dealing with is this. These sanctions need to be public, and so you'll have a number of credit bureaus which will take a look at the list and then, if there's a name that's similar or if the name may be the same, but doesn't have the same birthday or whatever, they'll put a flag by it. And then, in some instances, you'll find examples of businesses or others that just don't want to be bothered, or for whatever reason, aren't as careful as they should be in denying credit.

Senator DURBIN. Well, it seems like that would create a pretty serious hardship on some people—innocent people.

Secretary PAULSON. It does, and it's something we're concerned about. Now, what we do is, we've got a hotline that is open 24 hours a day. There are many, many, many calls. And Treasury is very quick about this. There are people that call because the name is similar, but not exact, or the name is the same but there's a different birth date. And these things get answered and get cleared up very quickly. So, how do we do this, and have you got any ideas? We ask ourselves, what can we do? We've got people manning these hotlines. There are literally thousands and thousands. The number that sticks in my mind is 90,000 calls over the last year, which received very quick answers. Whenever you have any list with sanctions, there's room for confusion if people don't use it properly. And Treasury's doing everything they can to make sure it is used properly.

Senator DURBIN. Let me recognize the Senator from Colorado.

Senator ALLARD. Well, thank you, Mr. Chairman, for holding this hearing.

I understand, in your opening remarks, you said you're going to have a separate hearing on the Internal Revenue Service. And I'm going to have some questions then, but I do have an opening statement I'd like to have made a part of the record, if we might.

Senator DURBIN. Without objection. We will also insert the statement from Senator Brownback.

[The statements follow:]

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Durbin for holding today's hearing.

The Treasury Department encompasses a number of important responsibilities, ranging from managing the government's accounts and the public debt; creating coins, currency, and stamps; supervising banks and thrifts; managing and promoting the domestic economy; promoting international trade and finance; detecting and preventing terror finance, money laundering, and other financial crimes; to administration of the tax code and collection of taxes owed. The breadth of these responsibilities perhaps belies the size of the $12.1 billion budget request.

While there are a number of areas of interest within the Treasury Department, I have the opportunity to delve into many of them on the Banking Committee; therefore, I intend to use my time today to examine some current practices of the Internal Revenue Service.

For some time now I have been concerned by increasingly hostile IRS actions towards conservation easements. Colorado has been a national leader in this area, so it is particularly worrisome to my constituents that the IRS is targeting legitimate easements for audits. It would appear that the IRS is attempting to dramatically narrow the number of legitimate conservation easements by applying a standard that has been struck down by federal courts two different times.

While I support investigation and enforcement of legitimate fraud, we must not target honest taxpayers, and Colorado's reputation should not be tarnished. There is a significant need for conservation easements in Colorado, and a few abuses should not end the charitable tax credit for everyone.

I have been in communication with the IRS over this matter for some months, however, I have been very frustrated that I am unable to get answers to my questions on this matter. Therefore, I will follow up with the Secretary in more detail during the question and answer period.

I would like to thank Secretary Paulson for appearing before the subcommittee. I recognize that he has a very busy schedule, so I appreciate his presence and look forward to his testimony.

PREPARED STATEMENT OF SENATOR SAM BROWNBACK

Good afternoon. I want to thank you, Chairman Durbin, for your leadership of this new subcommittee. I look forward to working together with you during this coming year as we make funding decisions and provide oversight to the various agencies within this subcommittee's jurisdiction.

Secretary Paulson, thank you for appearing before our subcommittee today. I look forward to hearing the details of your fiscal year 2008 budget request and the key efforts that your Department will be undertaking this year.

Looking at the President's budget, I am pleased that it assumes the continuation of the President's tax cuts, which have helped our economy rebound from recession to its current robust health. I am also pleased that the economy is continuing to grow steadily and am encouraged that the President's budget projects a balanced budget in 2012.

Mr. Secretary, the lion's share of your budget—approximately 90 percent—is for the Internal Revenue Service. I understand that you are seeking additional resources to close the so-called "tax gap." Certainly, we must ensure that taxes which are owed are collected. However, I remain concerned that our tax system is overly complex, complicated, and burdensome. Americans spend roughly $157 billion each year in tax preparation to ensure they do not run afoul of the IRS. The system is desperately in need of reform. I support a flat tax concept that simplifies tax preparation, applies a low tax rate to all Americans, and respects the special financial burden carried by American families raising children. One reason we have a "tax gap" may be that our tax system is so complex that taxpayers cannot figure out what they owe.

Mr. Secretary, I want to commend your Department for its efforts to combat terrorism. Your "Office of Terrorism and Financial Intelligence" is working hard to safeguard the financial system against illicit use and combating rogue nations, terrorist facilitators, money launderers, drug kingpins, and other national security threats. This is important work and I am supportive of your efforts in this area.

I understand that the President has asked the Treasury Department to aggressively block U.S. commercial bank transactions connected to the government of Sudan, including those involving oil revenues, if Khartoum continues to balk at efforts to bring peace to Sudan's Darfur region.

We know that Sudan's economy is largely dollar-based, meaning many commercial transactions flow through the United States. This fact makes Sudan vulnerable to your Department's actions. Anticipating Treasury's actions, there have been reports that Khartoum is exploring ways of obtaining oil revenues that do not involve dollars, such as barter deals. Clearly, we have an opportunity here to put greater pressure on Khartoum to enter into peace negotiations. Mr. Secretary, I am wholeheartedly supportive of these efforts and I would like to hear what actions you plan to take in the coming weeks and months.

Mr. Secretary, I look forward to hearing your testimony this afternoon. Your Department has an important role as the steward of our financial systems and in promoting our participation in the international economy.

Thank you for your leadership, Mr. Chairman. I look forward to working with you this year.

TAX ENFORCEMENT

Senator ALLARD. And I do want to ask a few questions related to the Internal Revenue Service, because it's an evolving issue in Colorado, and very important, and that has to do with conservation easements. The Congress passed some specific legislation providing for conservation easements, which is an incentive to have open space, you know, in your State. And what is happening in the State of Colorado is that the commissioners there, or the enforcers there, have—seem to be taking enforcement action that's over and beyond what's provided for in the legislation. They're being—they're interpreting it in a more strict way. It's, twice, gone to the courts, have been on—and the Internal Revenue has been overruled in the courts on two cases. And so, my question is, is why—after they've been overruled twice in the courts, why they're continuing to push this. I hope that you're aware of this. If you're not—and, if you are, somewhat, I'd like to get a response; if not, we can follow up with this when we're having the hearing on the Internal Revenue Service.

Mr. Secretary, do you have a response to that?

Secretary PAULSON. I'm not familiar with the issue, but I think you're right to follow up with Commissioner Everson. I think he would be the appropriate person to talk with about that.

Senator ALLARD. Well, I hope you have him adequately briefed, and tell him that I'm going to be waiting for him. And—hope I don't have—I hope I can be here, but I'm going to make every effort to be here, because I think this is really important.

Secretary PAULSON. Good.

Senator ALLARD. And then, also—and it's not that I don't think we ought—shouldn't be doing more to enforce our tax laws; I think we ought to be doing more. And I—you know, we're—there's actual—in the budget, more money, with the idea there's going to be more strict enforcement on collecting from those who are not paying their taxes.

PART PROGRAM

Now, in regard to that, you're familiar with the PART Program? This is the President's program, where he asked the agencies to set up goals and objectives; and then, if you don't meet those goals and objectives, or if you don't even bother to set those up, then there's a rating system that goes into that. And that is—you can find that PART Program rating on the Internet, by the way; you go to—the ExpectMore.gov—and if you go there, you'll find that there's one of your agencies that is rated as ineffective. If you were—if it was a classroom, that would be an "F." And it's the Internal Revenue Service earned income tax credit compliance (EITC). Have you looked at that particular program? Why is it ineffective?

Secretary PAULSON. Well, I would, respectfully, disagree, because this is something that I have looked at and spent some time with. I have actually spent some time with a number of people in the House and in the Senate, have gone out to a center, with John Lewis and Charlie Rangel, and here's the issue with the EITC.

Senator ALLARD. Now, this is the compliance aspect of EITC.

Secretary PAULSON. I understand that.

Senator ALLARD. Yes.

Secretary PAULSON. I'm going to get to that. And I'm going to say you should take a look sometime at the form and 53 pages of instructions. This is an area where it's easy to make mistakes. I sometimes get questions from the other side, which say, "Tell us why Everson and the IRS have so many people auditing this area, as opposed to the high net worth." And, I explain it's a totally different function. The audit is done from remote locations, and it is just looking at the forms, and checking for mistakes and errors and inconsistencies, which is a very different type of function. And it's not possible to transfer those people to do other things. So, we're doing our best. And we have quite an outreach program this year to help with the education, and we will, hopefully, as we move into the next tax season, find ways to simplify the form and make it easier. But, again——

Senator ALLARD. Well, I think that's key. And that was going to be my next question. You know, we need to—it seems to me like that needs to be simplified, and, hopefully, that that's within your purview to do that, and more clearly define goals and objectives so people understand where they're going to be, and put it in terms in which they can be measured.

Secretary PAULSON. Right. And you should ask, when he's here, because, he's spent a lot of time on this, himself—Commissioner Everson.

Senator ALLARD. Now, there are some programs under your purview that show "results not demonstrated." And the way those are explained to me is, those agencies have done nothing, or very little, to try and set up any measurable goals and objectives. And, in the Treasury, we have global environment facility of the Internal Revenue Service, healthcare, tax credit administration, Internal Revenue Service tax collection, Tropical Forest Conservation Act—are just a few that is named—are listed on here. Why aren't those agencies—why haven't they done anything at all to try and comply with PART? Why is their rating "results not demonstrated?"—and that's what that means, that they haven't been able to put together a management objectives program.

Secretary PAULSON. Well, I can't, again, accept the assertion that, with these programs or these areas, we don't have people that are working to achieve objectives. And if you would like to pick any of those programs that are of particular interest to you, I'd be happy to discuss it further and have the people involved come up and spend some—

Senator ALLARD. Well, they're of interest to me, because I'm on the Budget Committee and I'm on the Appropriations Committee.

Secretary PAULSON. Right.

Senator ALLARD. And I want to—I want to see taxpayer dollars spent on programs where we get results that has more——

Secretary PAULSON. Right.

Senator ALLARD [continuing]. We don't want programs out there running that have empty promises.

Secretary PAULSON. Well, I——

Senator ALLARD. And so, the reason for this whole program is that we have—the taxpayer dollars are going to programs that create measurable results, so that, as policymakers, we—and, as you know, this is—this evaluation is done by the Office of Management and Budget (OMB). And I suggest that maybe you sit down with them, see what you need to be doing, and—I'm just—what I'm trying to do, on this hearing, is to highlight it for you——

Secretary PAULSON. Right.

Senator ALLARD [continuing]. So that next year when you come in, you won't be—you'll know that we'll be looking at these—that this makes a difference in our thinking.

Secretary PAULSON. Well, let me give you an example, just on one of the programs, which is the global environmental fund. This is a multilateral fund that deals with environmental issues. And, in that case, we, the U.S. Government, have underfunded our request and our obligation, globally. And so, this is one where I know we had held back, because we had felt that certain objectives weren't being met. This year, we decided to fund it more fully, because we felt it was appropriate. And so, that's one. In terms of how someone in PART did the analysis, I can't comment on it.

Senator ALLARD. Well——

Secretary PAULSON. I can just tell you that we looked very carefully at everything we put in the budget.

Senator ALLARD. Well, we get down to the——

Secretary PAULSON. Right.

Senator ALLARD. I mean, I commend you for looking at that and evaluating it, and maybe it does need more money.

Secretary PAULSON. Right.

Senator ALLARD. And—but it would be interesting, now, to look at this program, next year, to see if the more money that you put in there got spent wisely. And if they—and I would hope that, on these international agencies, that you expect accountability in taxpayer dollars when they go into them.

Secretary PAULSON. We do. We expect accountability, and there's also a point, on some of these things, that, if we want to be global leaders, and if we want to play the role that people would like us to play at some of these multilateral organizations, that we have to put some money on the table. So, it's a tradeoff.

ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS

Senator ALLARD. Mr. Chairman, I have one more question, if you have time for that.

Would you like—let's see, on—the 2008 budget proposed creating an additional Assistant Secretary in the Office of International Affairs (OTA). Would you comment on why this is necessary, and what this position will be doing now that you're not currently doing?

Secretary PAULSON. Yes. This, to me, of all the things to defend, is the easiest. When I look at the role that I believe you should want Treasury to play in the world, and I look at the wide variety of issues that we're dealing with right now—you know, the strategic/economic dialogue with China; there's just a wide variety of things where we want to play a major role when we're dealing with our economic partners around the world—and if a man from Mars came down and looked at this in today's world and said, "They've got one assistant secretary in the international area," and then looked at the things that this man has on his plate, and the complexity of some of these issues, CFIUS being one of them, you know, the Committee on Foreign Investment——

Senator ALLARD. CFIUS?

Secretary PAULSON. Yes.

Senator ALLARD. The ports.

Secretary PAULSON. Yes. I would just simply say the level and the complexity of the issues we've got—Europe, Latin America, Asia—investment issues, trade issues—this is an important job. My Assistant Secretary for International right now is in Korea, helping Sue Schwab and her team with some investment provisions in an FTA they're trying to negotiate. It's a perfectly reasonable thing for him to be doing, but there's three or four other things he's not doing because he's there. And when I look at how other agencies are staffed, to me, this would be an important job to fill. And the interesting question, to me, is not why there's not two, it's why there's maybe not three. So, we went in, and have requested another assistant secretary.

Senator ALLARD. Well, thank you for your responses to my questions, and we'll follow up on the stuff on Internal Revenue on that hearing.

PART PROGRAM

I just—on all the—Mr. Chairman, on all these hearings that we have where we have the Secretaries show up who are in charge of the various Departments, I'm making an effort to sort of sensitize everybody to how important the PART Program is, because, as policymakers here on the congressional side, budget and appropriators, it's shedding information. And we get particularly concerned, I think, when we see something that's rated as ineffective. And if we—even worse yet, in my mind, is, we see an agency that is not demonstrating results, which, to me, lacks—shows a lack of effort.

Secretary PAULSON. Let me just make one additional comment. I do believe we should focus on performance, and we should have to justify performance. One of the things I learned in the private sector, how you measure that performance and who actually measures the performance, makes the difference. And so, sometimes—and I'm not making any comment about PART or any other program, this is just a general observation. Some of the performance measurements that I've looked at are not worth the paper they're printed on. We will take responsibility. We know we need to answer to you, and to others, for performance, and, on any of these things, we're just happy to spend the time, and I'm not saying we're perfect——

Senator ALLARD. Yes.

Secretary PAULSON [continuing]. Because I found plenty of issues, but——

Senator ALLARD. Well, if that's the case, I'd hope you'd sit down with——

Secretary PAULSON. Right.

Senator ALLARD [continuing]. OMB and work that out.

Secretary PAULSON. Right. Right.

Senator ALLARD. Thank you.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator.

FINANCIAL REPORTING

Mr. Secretary, the Office of Foreign Assets Control and the Financial Crimes Enforcement Network have been overwhelmed by a backlog of financial reports filed by financial institutions, prompted by a desire to err on the side of caution.

Secretary PAULSON. Right.

Senator DURBIN. The result is said to be an abundance of filings reporting only nominally suspicious activity or transactions. First, is this the case? How would you characterize the magnitude of the backlog there? And what percentage of suspicious activity reports received are actually examined?

Secretary PAULSON. Well, let me say that this is an area where one thing I've learned to do is listen. As we look at competitiveness in the financial services industry, and capital market's competitiveness, one issue we need to look at is regulation, and, is there a cost benefit? You know, are we putting too many requirements under its institutions?

Senator DURBIN. So, what do you think?

Secretary PAULSON. This has been an area that has been cited, and it's one we're in the process of looking at right now.

Senator DURBIN. Can you explain to me——

Secretary PAULSON. I don't know what we have—sometimes if you build a haystack too big, you can't find the needle. And I'm not saying we've done that, but we've got a new head of FinCEN, we've got a very outstanding young man, and he's got his hands full. But this is one thing that we will be looking at, at Treasury, and, again, talking to others at the Fed and elsewhere.

IRAQ THREAT FINANCE CELL

Senator DURBIN. Can you explain to us what the Iraq threat finance cell is and how it's operating?

Secretary PAULSON. No, sir.

Senator DURBIN. I'll give you a chance to respond to that in writing, if you would, please.

Secretary PAULSON. Yes.

[The information follows:]

IRAQ THREAT FINANCE CELL

The Department of the Treasury broadened its unique intelligence role overseas through the Baghdad-based Iraq Threat Finance Cell (ITFC). Since its establishment in late 2005, the ITFC has paid significant dividends. Co-led by the Departments of the Treasury and Defense, the ITFC collects, analyzes, and disseminates timely and relevant financial intelligence to the war-fighter. U.S and Coalition military commanders have come to depend on this intelligence to help combat the Iraqi insurgency and disrupt terrorist, insurgent, and militia financial networks.

FINANCIAL REPORTING

Senator DURBIN. Some critics question whether U.S. economic sanctions and financial regulation, as you've just said, place too much burden on financial institutions and international banks without providing sufficient guidance and training to implement the measures in a cost-effective way. One estimate from 2003 suggested the annual cost of U.S. anti-money laundering efforts for businesses was upwards of $7 billion. Do you agree that U.S. counterterrorist financing efforts have placed too much burden on the private sector?

Secretary PAULSON. As I said to you, I thought I tried to answer the question, you know, the first time you asked it—which is that this is something we're looking at. There is a cost benefit. We need to get it right. Those activities are very important, they're critical to our national security. So, what we need to judge is, is there a way where we could reduce the burden and get a better, more effective result? Okay? Because——

Senator DURBIN. That's being studied now?

Secretary PAULSON. That's being studied now—because the goal is to stop terrorism, to stop illicit financial activities. And it's a very important goal. And these programs have been very successful. So, the question we're now asking is, what's the right balance? You've asked the question, and I obviously think it's a good question, because I've asked the question, myself, and we're looking at it.

Senator DURBIN. I always like it when——

Secretary PAULSON. We really don't have an answer yet.

Senator DURBIN. I always like it when my questions are complimented. Thank you.

SUDAN POLICY

Let me ask you another. You and I had a conversation in my office about Sudan and Darfur, and I expressed my concern about this situation which President Bush has, I think, accurately characterized as a genocide. We talked about things that we can do, as a Nation, to put pressure on Khartoum, the Sudanese Government, to allow U.N. peacekeepers to come in and provide a rescue effort for these poor people.

I'd like to ask you, if you can, to tell me what the Treasury Department of the United States can do to help in this situation. Can we block Sudanese transactions that flow through U.S. banks, so that we can reduce the resources that the Sudanese Government can bring to bear against its own people? And what resources would you need to accomplish that, if possible?

Secretary PAULSON. Well, let me say, as you mentioned, we had a chance to talk about this. I've talked with the President a number of times about this. As you know, he's very committed and very passionate; talked with Secretary Rice, as she and Special Envoy Natsios are leading the efforts, Treasury is playing a support role, and, I believe, an important support role. We've had sanctions in place since 1997. You've identified one of the things we can do, which is to identify and disrupt dollar payments to Sudapet or other entities in Sudan, particularly those that go through the U.S. financial system. I think you will see, sometime in the weeks and months ahead, some actions taken that will show you that we're being active and diligent. I press people all the time, as does the President, to be creative, to think out of the box.

I know one thing we would like, and we're thinking it through, and we'll have some legislative suggestions. But right now, if we find a financing that is going through the U.S. banking system, we'd like the flexibility to charge a larger fine, because $50,000 per transaction may not be enough, when you run into a major transaction.

And so, there will be some things. And I do think this is one area, Mr. Chairman, where, knowing your commitment, we've had people up, briefing you, as much as you want to talk to our people. We're committed. If you've got ideas, we want to explore them and work with you, because this is very important.

Senator DURBIN. We had a classified briefing with Special Envoy Natsios just last week.

Secretary PAULSON. Yes.

Senator DURBIN. And we're working with him, and I won't go any further in my statements at this hearing, but if the Treasury Department needs additional resources at any point, we want to be there to help.

Secretary PAULSON. Right. And I think Treasury might have been there when you had that——

Senator DURBIN. Yes, I believe you were.

Secretary PAULSON. We had people there, so——

ECONOMY AND WAGES

Senator DURBIN. I'd like to ask you some general questions about the economy, because I think you have a unique perspective, having come from the private sector, now in the administration, dealing with some of the policy decisions that are being made. Our economy has clearly grown over the last several years, but there is ample evidence that the benefits of this growth have not been spread evenly across our population. Income inequality has been rising. Wages are not keeping up with productivity. And many families feel like they're being left behind. What do you think we should do to ensure that Americans benefit from the growth of our economy?

Secretary PAULSON. I think that is an important question, and one that I'm focused on. I would say this. When I came here, in July, and looked at the numbers—and, as a matter of fact, the first time I spoke on the economy, I talked about this issue—and it was my best judgment then that this was a time very much like the mid-1990s, and that if we kept adding new jobs and the top line stayed strong and productivity remained high, you would see that start to translate itself into real income growth for the average worker. And we've seen some real tangible signs of that. So, real income is now up 2 percent over last year. So, there's some positive movement.

But to get to your fundamental question, and the fundamental question really is that in this country, and in many other countries around the world, there's been a trend, that now goes back for almost three decades, which is the widening divergence between the top and the bottom. And there are different theories about this. Some people point to trade. I really believe that, by far, the biggest driver is technology and that what we're seeing—and there's been very, very major changes in productivity increases as a result of technology—and those people that are able to use technology and leverage themselves through technology, and have the skills that are most in demand, are getting the greatest benefits. So, I've got to believe that there are ways to do a better job than we, as a Nation, are doing. And I know this is something the President's talked about. It's education, but, more than education, longer-term education, it's training and skill development. And so, I do think, as I travel around the world and talk with people in other industrial nations, they're all focused on the same things.

HOUSING MARKET

Senator DURBIN. Could I ask you about a specific issue that came up last week in hearings on the Hill? It relates to the basic desire of people to own a home, and people with limited financial resources get involved in some pretty risky borrowing with the subprime lending——

Secretary PAULSON. Right.

Senator DURBIN [continuing]. To buy—to build a home, and some of them guessed wrong, they weren't able to keep up with the payments and now have been overwhelmed by the situation. The banks are unhappy, the consumers, the homeowners are unhappy, and a lot of us in the Senate are unhappy when we hear from them.

What's your view on the volatility in the subprime lending market? And how much impact do you think this'll have on our economy, as a whole? And can the Treasury do anything to address this issue?

Secretary PAULSON. I'll take a few minutes on this one, because it's very important, and, in some ways, it's complicated.

But let's begin with the fact that we are making—and I believe it will be a successful transition, but a transition from an economy that was growing at an unsustainable level to one that's going to be growing at a more sustainable level. There are a number of positive signs. Inflation seems to be relatively contained. The labor market remains strong. We've had exports growing faster than imports for four quarters now. And the consumer is hanging in there. But there's been a major correction in housing. And, of course, housing was growing at a level way above what was sustainable, for a number of years. And it's quite a significant correction. And it has impacted a lot of people.

It would appear to me that the housing—because you're dealing with the systemic impact on the economy—that it would appear that the housing correction is at the bottom, or near the bottom. We need to watch it longer, but that's what it would appear. It is then not surprising, as regrettable as it is, that you would have the issue with subprime mortgages and other mortgage resets. And this will take longer to work its way through the system.

Looking at it from a systemic standpoint—again, I'm going to get to the human situation in a minute, but from the systemic standpoint, my best judgment is that this is largely contained. And, in terms of people that have been impacted, it has to be a grave concern, and we need balance. I think, the understanding of the balance, that access to credit and credit availability made homeownership available to a good number of people, and we need to get that balance right. At Treasury, we're looking at it from the systemic standpoint and the impact on the economy, but we're also asking ourselves other questions, and we have a process going where we're talking with the Federal regulators and other regulators at the State level, and that you know, the regulatory structure is something that we're looking at, at Treasury, as it relates to financial market's competitiveness. We have a Balkanized regulatory structure, and, in a number of areas, we have multiple regulators sometimes competing with each other, and, in others, there seem to be some holes where there isn't as much regulation. So, we're looking at it from the consumer protection standpoint, predatory lending issues, fraud issues, and those sorts of things, and lessons learned.

But, again, I just want to emphasize, we want to take a careful, thoughtful look at this, and we don't want to rush to judgment or overreact, because, again, the availability of credit has been very important to millions of Americans.

FINANCIAL CREDIT

Senator DURBIN. I'd like to follow up on that. In my lifetime, and in yours, we have gone from an environment of usury laws to payday loans——

Secretary PAULSON. Yes.

Senator DURBIN [continuing]. From one extreme to the other.

Secretary PAULSON. Yes.

Senator DURBIN. And it strikes me that we do need some balance here. We want to make credit available, but I think there is credit exploitation taking place now. And I picked on payday loans, because, in my State, that—our State—that's the obvious place to go. But I also think it relates to credit cards and relates to a lot of credit that's now being extended to people, beyond their means, without real notification of the danger that they are courting if they're not careful. So, I hope, when you look at this, you will look at both sides of the equation, not only the availability of credit, but the abuse of credit by some institutions, at this point.

Secretary PAULSON. You're totally right. And as with everything in life, it's balance. It's like the question you were asking me about the anti-money laundering laws, Do we have the right balance? And that's the key question here.

DIALOGUE WITH CHINA

Senator DURBIN. I want to ask you—last question—about China, because you've shown an interest in China, and I've been watching your efforts to the strategic/economic dialogue over the past month. I thank you for bringing this issue to the fore. And obviously we have some concerns at Capitol Hill, and at home, and about whether the Chinese will float their currency soon. Will they shut down the rampant intellectual property theft that we know has robbed many American businesses of untold revenue? Will they enforce better labor, environmental, and human rights standards? And what steps is the administration taking to move in these directions?

Secretary PAULSON. Well, thank you for asking that question. This is a major focus of mine, and I think, as you know what we're doing through the strategic economic dialogue is getting all the agencies, departments in the U.S. Government that deal with economic issues to come together, prioritize, and speak with one voice to the highest levels of the Chinese Government.

Now, let me take two issues you mentioned, because we're dealing with longer-term structural issues in the dialogue, but we also are dealing with the pressing short-term issues, which need to be solved. Take currency as an example. The renminbi, clearly we need more flexibility and we need more appreciation in the short term, and we're pushing very hard, and that's important, in our country—and, frankly, it's important in their country if their market's going to develop in a way in which it's going to be good for them and good for us. But we also need to get to the point where they can have a market-determined currency, because many countries in the world have managed currencies, many of them don't have market-determined currencies. But China is, by far, the largest that doesn't have a currency whose value is set in a competitive marketplace. And so, they're in this situation where they're a big part of the global economy, they're integrated into the global economy, in terms of trade and products and services, but their financial markets are very, very immature, they are not integrated into the markets. And so, a big part of what I need to do, and what I have been doing—and I was, matter of fact, in Shanghai several weeks ago, giving a speech on the need to reform their capital markets and open up to competition, because only when they do that are they going to be able to get to the point where we all want them to get, where they have a currency that trades in a competitive marketplace. And then, the other benefit is that right now they have a savings rate at a precautionary level, at 50 percent. And why do their individuals save at such a high level? Well, frankly, because they are not getting any reasonable return on their savings.

There's over $2 trillion in Chinese banks earning 2½ percent, which is negative after taxes and after inflation. And when you look at what we can get as a return in a savings plan, a pension fund in the United States or other industrialized nations that are growing at much lower levels than China, and you translate and say, if Chinese savers in their pension plans were able to get 8 percent, then we would have the kind of economy they'd like to have and the kind of economy we would have. And that's really going to be the only way we're going to be able to satisfactorily address the trade balance program.

Now, on intellectual property, you're right, a very sensitive issue. This is something that is handled by USTR and Commerce through the JCCT. I do everything I can to help out, and we deal with that negotiating and also through the World Trade Organization (WTO) which has ways of resolving disputes, and so, we have a number of ways to go about trying to enforce proper laws, and this is quite important.

PRIVATE CAPITAL

Senator DURBIN. I said that was the last question. It turns out there's one I really have to go to, because it is important, and I hope you'll forgive me for one more question. And it's in an area that is a complex area. But the President's working group recently released principles and guidelines on private pools of capital.

Secretary PAULSON. Right.

Senator DURBIN. This principle-based framework generally relies on market discipline to strengthen investor protection and guard against systemic risk. Do you consider this a first step toward addressing the challenges presented by the growth of hedge funds? And, if so, what additional steps are being considered? And what evidence is there that this indirect approach to hedge-fund supervision is more effective than direct approaches, such as those employed by the United Kingdom Financial Services Authority, in protecting investors and mitigating systemic risk?

Secretary PAULSON. Well, again, that's a big important question, and let me do my best to answer it in a few minutes.

First of all, there is no doubt that the global capital markets have changed significantly over the last 5 years, in particular. And there has been a big growth in private pools of capital, which are often referred to as hedge funds or private equity funds. And there's been a big increase in over-the-counter derivatives, as opposed to exchange-traded derivatives.

As we've studied this at the President's working group, we've all concluded that, by and large, these are positive developments. They've helped disperse risk, make the markets more competitive and more efficient. But they're not without challenges. And so, we've thought about it very carefully, and, as we addressed it, what we came out of our deliberations with was something which I thought was quite important, because we had members of the President's working group and other important regulators, like the OCC, all come together and, with one voice, say, "This is how we want to deal with this." And the focus was really in two areas—first of all, is systemic risk, managing systemic risk. And here, there is quite a proactive focus in dealing with the regulated entities—the banks, the prime brokers, and others that lend money and provide credit—and making sure that there is the proper liquidity, its transparency, all of those sorts of things. And then, on the investor protection end, the Securities and Exchange Commission's (SEC) obviously got a big role to play, in terms of their anti-fraud, and in terms of the threshold levels for investors to come into these funds. And, again, there is a big emphasis on transparency.

Now, it is our view that—to have all of the regulators come together and, with a principles-based approach, emphasizing market discipline, and all speaking with one voice, would be a major development. And we're going to watch this, continue to study it, see how things develop.

There's also a good deal of work that is really being coordinated under Tim Geitner, at the New York Fed, dealing with derivatives. And, again, they're dealing with a lot of the settlement issues, clearing settlement, the infrastructure issues, making sure that there are contracts that work in times of stress, that sort of thing. So, there's a lot of work being done in all of these areas, and we're going to continue to look at them.

Senator DURBIN. I'm sure that you remember the collapse of the Long Term Capital Management Group.

Secretary PAULSON. Yes.

RISK MANAGEMENT

Senator DURBIN. The President's working group released a report that contained a number of recommendations for improving risk management practices at the financial institutions that conduct transactions with hedge funds. What evidence is there that these recommendations have been implemented and that such implementation has reduced systemic risk from hedge-fund activity?

Secretary PAULSON. Well, again, that's a complicated question. Just as an observation, I'm not going to say there's a cause and effect—but we haven't had a financial shock since 1998. So, we need to go back to long-term capital.

I do believe, as someone who was in the financial sector when these recommendations came out, they made a difference. People looked at them. I think that there are real benefits, but there are challenges. And I think what we came out with—I was really gratified that we had all of the regulators, in the United States—the Federal regulators—come together with a forward-leaning approach, and we're going to watch this very carefully, and keep looking, and, if other steps need to be taken, we will recommend them.

SARBANES-OXLEY REQUIREMENTS

Senator DURBIN. Last question, for sure. Sarbanes-Oxley. Some of our mutual friends, in Chicago and other places, tell me it just goes too far, too darn many requirements, too expensive, discourages people from serving on corporate board of directors. And some of our other friends, mutual friends, say, "Thank goodness for Sarbanes-Oxley"—restored the integrity of our corporate structures after the scandals of Enron and other companies, and were it not for that integrity, we would just be another competitor in the global scene. We have a primacy, because we do have tougher requirements, and people know there's transparency and accountability. So, where does Secretary Paulson come down on Sarbanes-Oxley?

Secretary PAULSON. Well, let me say that I've given a very long speech on the topic, which is probably too long for you to hear today. We had a Capital Markets Competitiveness Conference the other day, which was, I believe, quite successful. We will have follow-up on things we're going to do in three areas, but I'm going to try to summarize some of my thoughts for you. But, again, it'll be very similar to what we've said in some other things, that it's a matter of balance.

Now, if you look specifically at the Sarbanes-Oxley legislation, I don't see—and I don't think—there have been a number of groups that studied it, and I think they've all concluded the same thing—it doesn't take a legislative fix. There are very good principles in that legislation, and, matter of fact, some of the abuses that have taken place, really, most of them were before that legislation, as it related to some of the abuses in the options areas and others. So, I think when people talk about Sarbanes-Oxley, they're using that as a shorthand for not just the law, but the implementation of the law, and the regulatory and enforcement environment, and the legal environment, and the fact that because the corporate scandals were accounting scandals, for the most part, and there were, then significant reforms, that there are also a number of ways in which the relationship between accountants and boards have changed, all of which are not constructive. And so, the question is now not, are there some issues? Because there are some issues. The question is what to do about it. And a lot of it is balance, a lot of it is taking a risk-based approach, looking at the cost and the benefits, and not saying, "We want to regulate—that if we regulate to a large extent, we can eliminate losses or what have you."

So, we will be coming out with some ideas that deal with, first of all, regulatory structure, and, what are the issues surrounding regulatory structure in the United States? We'll be coming out with some steps that might be taken and thoughts we have in the accounting area. A very important step has already been led by Chairman Cox and Chairman Olson, of the SEC and PCAOB, on the way in which something that's called section 404 of Sarbanes-Oxley is implemented, which is a very simple provision of the bill, but has to do with an accounting standard relating to control systems, and it's a place where implementation was very flawed, the cost-benefit equation got way out of balance, and it's got to be put back in balance.

So, there are the accounting issues that we'll look at, and then look at the enforcement in the legal environment. But, again, I think, often when people talk about Sarbanes-Oxley, they don't really mean the bill, because if you say, "Now, tell me, what specifically would you change in the bill?"—what they talk about is, there's been so much change that happened in such a short period of time that everyone in the private sector is still trying to digest that change and get it in the proper balance.

Senator DURBIN. Mr. Secretary, thank you for your patience. I'm sorry we got started so late.

I want to thank all those who participated in preparing for this hearing. I appreciate the benefit of hearing from you about the Department. I think this forum has provided us some insight into the Department's operations, which will help us in our budgetary considerations.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open for a period of 1 week, until Wednesday, April 4, at noon, for subcommittee members to submit statements and their questions for the record.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

ALTERNATIVE TO OUTSOURCING: FEDSOURCE—STAY AT TREASURY OR MOVE TO GSA?

Question. Franchise Funds were established by Congress under the Government Management Reform Act of 1994 to foster competition and creativity in government. "FedSource" operates under the franchise granted to the Treasury Department to provide business services to federal agencies on a competitive, cost-reimbursable basis. It has been reported that the Treasury Department may transfer this ability to the General Services Administration or Defense Logistics Agency.

Mr. Secretary, can you explain to me why you are thinking about relinquishing this program and the potential timetable for doing so?

Answer. The Treasury Department strongly supports Franchise Funds as a means of fostering competition in government. Treasury's Franchise Fund components will continue to offer administrative services such as travel, procurement, personnel and accounting. Only one component, FedSource, is affected.

The Treasury Department will transition out of the interagency acquisition business operated by FedSource for two primary reasons:

—The original purpose of FedSource was to provide small-scale and limited acquisition support, which met the Treasury Department's strategic needs at the time of its creation. However, the significant increase in activity related to customer demand has required an increase in operational commitment that is not compatible with the core mission and focus of the Department. Treasury management, both at the Department and at the Bureau of the Public Debt, has significant concerns with the risks associated with sustaining the current business model. In addition, recent reports by the Treasury Inspector General and the Defense Department Inspector General identified control weaknesses and procurement deficiencies.

—Other government organizations (e.g., the General Services Administration and Defense Logistics Agency) whose core missions include providing these types of procurement services may be better positioned to provide these services at the best value to taxpayers.

The Treasury Department will ensure a smooth and orderly transition process. The goal is to complete the transition, which will be managed by the Bureau of the Public Debt, by September 30, 2008.

The Treasury Department is committed to protecting taxpayer resources, quickly addressing management issues, and operating the Department in the most efficient and effective way possible.

Question. For the 10th consecutive year, certain material weaknesses in financial reporting and other limitations on the scope of its work resulted in conditions that prevented GAO from expressing an opinion on the federal government's consolidated financial statements. A major factor contributing to the GAO's disclaimer is the federal government's ineffective process for preparing the consolidated financial statements. As reported by GAO, such weaknesses in the consolidated financial statements preparation process impair the U.S. government's ability to ensure that these statements were (1) consistent with the underlying audited agency financial statements, (2) balanced, and (3) in conformity with U.S. generally accepted accounting principles.

Although Treasury has made progress in addressing some of these identified weaknesses, what more can be done to timely resolve such problems so that this area is no longer a major impediment to the federal government receiving an opinion on its consolidated financial statements?

Answer. Each year Treasury, through the Financial Management Service (FMS), continues to improve its policies, procedures, information systems and internal controls used to prepare the government-wide consolidated financial statements (formally the Financial Report of the United States Government or FR) and will continue to do so. During the fiscal year 2006 audit, FMS' efforts resulted in the resolution of approximately 60 GAO recommendations. FMS will continue to resolve the preparation issues that are in our realm of control. However, there are other preparation data integrity issues that depend on accurate and consistent data being submitted by the agencies.

FMS is working diligently on providing the agencies with guidance, tools, and assistance to improve the accuracy and consistency of the agency data to the point where the issues identified by GAO are mitigated or resolved at the FR preparation level. The following discussion provides FMS' planned actions to address those recommendations, as well as the initiatives that FMS is implementing to help the agencies improve their data accuracy and consistency.

Consistency with agency audited financial statements

FMS currently uses the Government-wide Financial Reporting System (GFRS) as the principal information system to collect agency audited financial statement information and produce significant portions of the FR.

In fiscal year 2006, GAO acknowledged and noted improvements with regard to consistency with agency information in the Balance Sheet, in the Statement of Net Cost and Statement of Social Insurance, and in the note disclosures that are directly linked to the amounts on these principal financial statements. FMS is currently revising its policies in fiscal year 2007 to ensure that the remaining notes are materially traceable to agency note disclosures.

FMS has two major initiatives which will modernize longstanding Federal accounting processes and provide agencies with methodologies and tools to improve the accuracy and consistency of their financial data:

—The Government-wide Accounting (GWA) Modernization project which will replace existing government-wide accounting functions and processes. This project will improve the reliability, usefulness, and timeliness of the government's financial information, provide agencies and other users with better access to that information, and will eliminate duplicate reporting and reconciliation burdens by agencies, resulting in significant government-wide savings. It will also improve the budgetary information being collected from the agencies at the transaction level.

—The Financial Information and Reporting Standardization (FIRST) initiative integrates budget and financial reports from Federal Program Agencies. FIRST will improve the consistency of the budgetary and proprietary accounting data recorded in agency financial statements and reported to FMS through its trial balance.

Balanced Consolidated Financial Statements

A major challenge in preparing balanced financial statements is properly accounting for and eliminating unreconciled intra-governmental transactions. Some of these transactions occur solely between two federal agencies while others occur between the agencies and the general fund. FMS is taking the following actions to address this issue:

—Requiring comprehensive intragovernmental accounting data from agencies on a quarterly basis that will allow FMS to provide data to all federal agencies for them to better analyze and reconcile intragovernmental differences.

—Working with the CFO Council and OMB to enforce the business rules for intragovernmental transactions and to organize the Dispute Resolution Committee.

—Encouraging greater auditor participation by requiring agency auditors to more closely scrutinize intra-governmental out-of-balance conditions with other agencies.

—Moving forward on the FIRST initiative which is being designed to provide authoritative information contained in Treasury's central accounting system to the agencies to facilitate the reconciliation process for specific intra-governmental transactions.

Compliance with GAAP

During fiscal year 2006, FMS made significant improvements in improving overall GAAP compliance. FMS was able to significantly reduce the number of audit findings relative to GAAP compliance. For fiscal year 2007, FMS will

—Use the Chief Financial Officers (CFO) Council, Central Agency Reporting Subcommittee as a forum to discuss those accounting and reporting issues that affect the FR.

—Focus on the remaining material items with the expectation that the findings related to these items can be closed by GAO either this year or next year.

—Continue to revise and update the Treasury Financial Manual with accounting, reporting, and disclosure policies and procedures to ensure compliance of the FR with generally accepted accounting principles (GAAP).

Question. TFI is home to the newest addition to the U.S. intelligence community: the Office of Intelligence and Analysis (OIA).

How well is the office being integrated into the intelligence community?

How would you characterize the degree of intelligence sharing that takes place between Treasury and the rest of the intelligence community?

Do any barriers to intelligence sharing exist?

Answer. Since the creation of the Treasury's Office of Intelligence and Analysis (OIA) under the Intelligence Authorization Act of Fiscal Year 2004, it continues to build relations throughout the Intelligence Community (IC). In particular, OIA has developed important partnerships within the leadership of the IC, through collaborative projects, information sharing, and community support.

Even though OIA is one of the newest and smallest intelligence elements in the IC, it participates on key IC committees. On April 9, 2007, Director of National Intelligence (DNI) McConnell created an Executive Committee to serve as the principal decision-making and advisory board for the IC. Treasury's Assistant Secretary for Intelligence and Analysis, who manages OIA, was designated a member of that committee. In addition, the Deputy Assistant Secretary for Intelligence and Analysis and OIA's policy staff have been involved in ODNI boards and committees that have been responsible for setting policy for the IC, standards of analysis, and driving change in the IC culture.

Through exchanges and detail assignments at the working level, OIA has built strong relationships with IC counterparts. Since OIA was created, it has hosted representatives from the Federal Bureau of Investigation (FBI), National Security Agency (NSA), the United States Central Command (CENTCOM), the Joint Warfare Analysis Center (JWAC), and other key intelligence partners. Moreover, OIA has detailed analysts to CENTCOM, the United States Pacific Command (PACOM), and the United States European Command (EUCOM). The 2008 President's budget request includes increased resources to expand OIA's detail assignments.

A good example of how well OIA has integrated into the IC, as well as the high degree of intelligence sharing, is found in Treasury's Weapons of Mass Destruction (WMD) proliferation program. In order to work on targeting and researching potential targets for Treasury sanctions against WMD proliferators under Executive Order 13382, the Defense Intelligence Agency (DIA), with the assistance of the Director of National Intelligence, detailed several analysts to OIA. The DIA analysts have helped to expand and accelerate Treasury's activities on this program.

A key element to OIA's integration into the IC is the ability to send and receive information relevant to Treasury's mission. Primarily a consumer of information, OIA has regular access to the intelligence it requires to prepare administrative records in support of targeted financial measures against terrorist supporters. While OIA produces very little raw information, it is producing both analytic cables and finished analytical products for dissemination to the IC. To aid the dissemination of those products, OIA has developed a Top Secret/Sensitive Compartmented Information (SCI) website that can be accessed by partners throughout the IC. Internally, OIA has access to Top Secret/Sensitive Compartmented Information (SCI) through the Treasury Foreign Intelligence Network (TFIN), an information technology system that is being redesigned and updated in fiscal year 2007.

While OIA has made significant progress integrating itself into the culture of the IC, working to be a full partner in the intelligence enterprise, there are still some barriers that result from a continuing lack of understanding in other IC elements about OIA's IC role and expertise. As other IC components, however, become more familiar with OIA, this limiting factor will become less of an issue.

Question. It has been asserted that OIA is primarily reactive, analyzing information that is provided to TFI by U.S. and other financial institutions.

Is TFI able to initiate or influence intelligence collection priorities?

Answer. Treasury's Office of Intelligence and Analysis (OIA) is a member of the Intelligence Community (IC) and provides all-source analysis, derived from intelligence, law enforcement, regulatory, and open sources, to Treasury and IC customers. As an IC member, OIA is able to ensure that its intelligence needs are met through the intelligence requirements process. In particular, OIA's involvement in national requirements mechanisms is enhanced by experienced analysts initiating and contributing to tactical requirements.

National Requirements

In 2005, OIA achieved a significant milestone by hiring a dedicated collection requirements officer. This officer has ensured that Treasury equities in financial, economic, enforcement, and other information needs are reflected in national intelligence priorities and collection requirements. Among the various national bodies with which OIA engages include the U.S. SIGINT Committee and its Analysis and

Production Subcommittee, the Community HUMINT Management Office, the National HUMINT Requirements Tasking Center, various National Clandestine Services offices, the Open Source Center, and various CIA Directorate of Intelligence offices. In addition, OIA's subject matter experts work closely with the Director of National Intelligence's (DNI) Mission Managers, particularly those at NCTC, NCPC, Iran, and North Korea, to ensure Treasury priorities are incorporated into national collection and analysis strategies for these hard targets.

Tactical Requirements

OIA analysts actively provide feedback and direction on disseminated intelligence reports to ensure that information relevant to Treasury's mission is collected. Critical partnerships developed by Treasury in the last few years have enhanced this process. OIA analysts regularly engage with counterparts in collecting offices across the IC. Detail assignments and exchanges are particularly useful for communicating Treasury needs and priorities to partner agencies. OIA, for example, hosts several detailees from NSA to assist with its SIGINT collection needs. Another example is the Iraq Threat Finance Cell (ITFC) in Baghdad, which OIA co-founded and co-leads. The ITFC has worked diligently to increase the quantity and quality of reporting on terrorist and insurgent financing in Iraq, with considerable success.

Question. Treasury has recently completed an initial study of the feasibility of mandating financial institutions to report cross-border wire transfer data. The study concluded that such reporting is technically feasible and might prove valuable in combating money laundering and terrorist financing. The report also noted that the proposed program could result in the filing of half a billion new financial reports by financial institutions.

Given the additional costs that this might impose on the financial sector, do you believe mandating the reporting of cross-border wire transfer data is necessary and desirable?

Answer. The Intelligence Reform and Terrorism Prevention Act of 2004 contained two mandates related to the potential collection of cross-border electronic funds transfer reports. First, the Act directed that the Department study the feasibility of implementing a system to receive, store, process, analyze, disseminate, and secure such data. Second, the Act directed the Department to implement such a system if the Secretary deemed it "reasonably necessary."

In its study, FinCEN concluded that the implementation of such a system is, indeed, feasible. FinCEN also identified a number of important policy questions that must be considered before the Department of the Treasury can make a final determination whether such a requirement is reasonably necessary. One of the primary concerns is the potential cost to the financial services industry. Therefore, FinCEN proposed conducting an additional cost-benefit analysis to support a final decision by the Secretary whether such a requirement is reasonably necessary. This cost-benefit analysis will directly address the potential costs to the financial services industry, and the potential value of the data to U.S. government efforts to combat illicit financing. Only after assessing these issues will the Department be able to reach a conclusion about whether mandating the reporting of such data is necessary and desirable.

As part of the study FinCEN will:

—explore the potential, but as yet unquantified, risks to the operations and competitiveness of the U.S. financial services industry;

—further refine the use cases and requirements of our law enforcement and regulatory partners, which FinCEN describes in its Study; and

—extend the preliminary assessment of the potential value of such data in our collective efforts to combat illicit financial activity.

Question. Recent U.S. Executive Orders and the USA PATRIOT Act gave Treasury a greatly expanded tool-kit to combat terrorist financing. Subsequently, many of these measures have been used to curtail the international financial operations of rogue states such as Iran and North Korea.

Can these measures be used more aggressively against non-state terrorist organizations? What operational challenges might you face?

Please discuss how Treasury's use of its new authorities is viewed internationally, especially among our allies. Is getting foreign countries and companies to cooperate with U.S. measures a problem?

Answer. The Department of the Treasury is acting aggressively against non-state terrorist organizations. We actively target al Qaida-related and Hizballah-related organizations under our relevant Executive Orders. Additionally, Treasury continues its effort to increase financial pressure on Hamas. A few examples of Treasury's recent activity utilizing our expanded tool-kit to combat terrorist financing include:

—On February 20, 2007, Treasury designated Jihad al-Bina, a Lebanon-based construction company formed and operated by Hizballlah. Jihad al-Bina receives direct funding from Iran, is run by Hizballah members, and is overseen by Hizballah's Shura Council, at the head of which sits Hizballah Secretary General Hassan Nasrallah.

—On January 26, 2007, Treasury designated two South African individuals, Farhad Ahmed Dockrat and Junaid Ismail Dockrat, and a related entity for financing and facilitating al Qaida, pursuant to Executive Order 13224. This financial measure freezes any assets the designees have under U.S. jurisdiction and prohibits transactions between U.S. persons and the designees.

—On December 6, 2006, Treasury designated nine individuals and two entities that have provided financial and logistical support to the Hizballah terrorist organization. The designees are located in the Tri-Border Area (TBA) of Argentina, Brazil, and Paraguay and have provided financial and other services for Specially Designated Global Terrorist (SDGT) Assad Ahmad Barakat, who was previously designated in June 2004 for his support to Hizballah leadership.

These designations, among many others, highlight Treasury's use of authorities granted by U.S. Executive Orders.

Treasury's actions are most effective when other nations amplify our designations with their own measures. Thus, the most significant operational challenge has been when other states have not implemented remedial actions against designated targets. Treasury is working to address this issue through a variety of mechanisms, among them, the U.S.-EU Terrorism Finance Troika and the U.S.-EU Workshop on Financial Sanctions to Combat Terrorism. Treasury has also worked with USUN and other elements at the United Nations to advocate for the adoption of U.N. Security Council Resolutions aimed at combating terrorist financing. For example, UNSCR 1735, adopted in December 2006, is a follow-on resolution to UNSCR 1267 and it reiterates the international community's condemnation of al Qaida, Osama bin Laden and the Taliban, as well as the international commitment to countering terrorism and terrorist financing via measures that include a targeted economic sanctions regime (e.g., asset freeze and ongoing prohibition of commercial and economic dealings), a travel ban, and a ban on the sale or supply of arms and related material. Additionally, Treasury works with the Financial Action Task Force (FATF) to establish standards and commitments on targeted financial and economic measures that form a framework for multilateral action and cooperation in the fight against illicit financing. These efforts are bolstered through our work with the G–7, the International Monetary Fund (IMF), the World Bank, and FATF-Style Regional Bodies (FSRB).

Acting multilaterally and working with various foreign governments and international organizations and companies to increase the effect of our actions are high priorities of the Treasury Department. Treasury has initiated strategic dialogues with all relevant parties of the international community and we enjoy great success and continued cooperation. Generally, foreign countries and private companies are eager to abide by and cooperate with U.S. authorities. Recently we have seen many international financial institutions implement their own measures to protect themselves from deceptive conduct without waiting for their governments to impose specific requirements and regulations.

COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

Question. The Committee on Foreign Investment in the United States is an interagency committee chaired by the Secretary of Treasury. CFIUS (SIF–EUS) seeks to serve U.S. investment policy through thorough reviews that protect national security while maintaining the credibility of our open investment policy and preserving the confidence of foreign investors here and of U.S. investors abroad that they will not be subject to retaliatory discrimination.

Can you explain briefly to the Committee why the Committee on Foreign Investment in the United States (CFIUS) was established? What is its purpose?

In your opinion, how well is it doing at achieving its purpose?

What changes have been made in the operations of CFIUS during the past year? Who are the members of CFIUS?

What role does the Director of National Intelligence play in the CFIUS process?

As you know, the House recently passed legislation aimed at enhancing Congressional oversight of the CFIUS review process. What is the Department's position on that bill?

Answer. CFIUS was established by Executive Order 11858 in 1975. The Secretary of the Treasury was designated as the chairman of CFIUS. Its original mission was to have primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of U.S. policy on such investment.

In 1988, the President, pursuant to Executive Order 12661, delegated to CFIUS his responsibilities under section 721 of the Defense Production Act of 1950 ("Exon-Florio" amendment) to receive notices of foreign mergers and acquisitions of U.S. companies, to determine whether a particular acquisition has national security issues sufficient to warrant an investigation, and to undertake an investigation, if necessary, under the Exon-Florio provision. In addition, it allows the President to take action, if necessary, to suspend or prohibit any transaction that, in his judgment, threatens the national security.

In essence, the purpose of CFIUS is to protect national security while keeping our country open to investment, which is critical to a strong U.S. economy.

In the past 20 years, CFIUS has investigated over 1,700 cases. To the best of our knowledge, the CFIUS agencies have implemented Exon-Florio in a manner that has achieved the national security objectives as prescribed in the statute without compromising our open investment policy. Investigations are conducted by analysts with expertise from across the agencies in a professional and non-partisan manner.

CFIUS has already implemented many of the reforms proposed by Congress. These include, among others:

—*Notification*.—We now inform the relevant congressional committees of every case once deliberative action has concluded under Exon-Florio.

—*Briefings*.—We are providing periodic briefings to Congressional oversight committees on all cases once deliberative action has concluded.

—*Accountability*.—At Treasury, every case is briefed to senior policy levels, and only Senate-confirmed officials may close a CFIUS review.

—*Role of the DNI*.—We have formalized the role of the intelligence community by having the Office of the Director of National Intelligence serve as advisor to CFIUS, facilitating a coordinated analysis of each case by the intelligence community.

CFIUS includes six departments and six White House agencies. Specifically, the members of CFIUS are the Departments of Treasury, State, Defense, Justice, Commerce, and Homeland Security, as well as the Office of Management and Budget, the Council of Economic Advisers, the U.S. Trade Representative, the Office of Science and Technology Policy, the National Security Council and the National Economic Council. Other agencies, such as the Departments of Energy or Transportation, may be brought in when specific expertise is required in the investigation of a transaction.

The Office of the Director of National Intelligence has a non-policy role as advisor to CFIUS, facilitating a coordinated analysis of each case by the intelligence community.

The Administration's position on H.R. 556 is provided in the Statement of Administration Policy (SAP) submitted to the House on February 27, 2007, which we attach to these responses. In sum, the Administration regards national security as its top priority and supports the intent of the House bill to address national security imperatives in a post-9/11 world. We support enactment of legislation that will improve and strengthen CFIUS to ensure the protection of America's homeland and the strength of the U.S. economy. The SAP lays out the Administration's concerns about several provisions of the bill.

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF MANAGEMENT AND BUDGET,
Washington, DC, February 27, 2007.

(HOUSE RULES)

STATEMENT OF ADMINISTRATION POLICY

H.R. 556—NATIONAL SECURITY FOREIGN INVESTMENT REFORM AND STRENGTHENED TRANSPARENCY

(REP. MALONEY (D) NY AND 58 COSPONSORS)

The Administration supports House passage of H.R. 556 and appreciates the efforts of the House Financial Services Committee to strengthen the Committee on Foreign Investment in the United States (CFIUS). The Administration regards the Nation's security as its top priority. In addition, the Administration views investment, including investment from overseas, as vital to continued economic growth, job creation, and building an ever-stronger America. Therefore, the Administration seeks to improve the CFIUS process in a manner that protects national security and ensures a strong U.S. economy and an open investment environment that will serve as an example and thereby support U.S. investment abroad.

In light of the President's responsibility to ensure the Nation's security, and in the context of comity between the executive and legislative branches, we believe the President should retain substantial flexibility to determine CFIUS's membership and administrative procedures and to make adjustments when national security so requires. Accordingly, the Administration has concerns with some of the provisions of H.R. 556 and looks forward to working with Congress to address these concerns, to strengthen CFIUS, and to ensure the protection of America's homeland and the strength of our economy.

Establishment and Membership of CFIUS

The President should retain the flexibility to determine and adjust the appropriate Executive Branch membership of CFIUS and their roles. H.R. 556 should not mandate that CFIUS have Vice Chairs, nor that CFIUS include members of the Executive Office of the President. Further, the President should retain the flexibility to determine roles and responsibilities of CFIUS and its members. For example, the Administration opposes any language in Section 6 that would call for the designation of a lead agency or agencies to represent other agencies or the Committee in negotiating, entering into, imposing, modifying, monitoring, or enforcing mitigation agreements.

Deliberations and Decision-Making of the Committee

The Administration is concerned that the legislation imposes procedural requirements, such as roll call voting and motions, which are ill-suited for executive bodies such as CFIUS and are inconsistent with the vesting of the executive power in the President. Given the bill's reporting requirements, such procedures will deter the full and open interagency discussion that is required to consider CFIUS cases properly.

The Administration fully shares Congress' goal of ensuring senior-level accountability for CFIUS decisions. The Administration supports requiring the Secretary, Deputy Secretary, or an Under Secretary of the Treasury to sign CFIUS decisions at the conclusion of a second-stage (45-day) investigation, as H.R. 556 provides. With respect to cases for which CFIUS concludes its action at the end of the first-stage (30-day) investigation, the Administration supports the House Financial Services Committee's decision to authorize delegation of this authority. However, in view of the volume and variety of cases and to ensure that our most senior officials are able to focus on those cases that do raise national security concerns, this authority should be further delegable to other officials appointed by the President and confirmed by the U.S. Senate.

The Administration believes that the current 30-day and 45-day time frames for first-stage and second-stage investigations provide CFIUS with sufficient time to examine transactions. The possibility of extensions may discourage foreign investment by generating uncertainty and delay for the parties to proposed transactions. The Administration therefore opposes allowing CFIUS to extend the second stage (45-day) investigation period. The Administration notes that the current CFIUS practice of encouraging parties to transactions to consult with CFIUS prior to filing provides CFIUS with additional time and flexibility to examine complex transactions.

The Administration supports the role of the intelligence community as an independent advisor to CFIUS and appreciates the bill's inclusion of a provision that ensures that the Director of National Intelligence (DNI) is provided adequate time to complete the DNI's analysis of any threat to the national security of a covered transaction. However, language in H.R. 556 also appears to provide the DNI with the ability to force a second-stage (45-day) investigation if the DNI has identified particularly complex intelligence concerns and CFIUS was not able to satisfactorily mitigate the threat. Such a policy role would be inconsistent with the independent advisory role of the DNI envisioned in the legislation and supported by the Administration.

Notification and Reports to Congress

The Administration supports enhanced communication with Congress on CFIUS matters to better facilitate Congress' performance of its functions. CFIUS should be required to notify Congress of transactions only after all deliberative action is concluded, as H.R. 556 provides. As discussed above, roll call voting, particularly if reported outside the Executive Branch, would deter the full and open interagency discussion that is required to consider CFIUS cases, and reporting on internal Executive Branch deliberations, including the positions of individual CFIUS members, should not be required.

Authorities of CFIUS

The Administration believes current law and regulations give the President and CFIUS adequate authority to gather all information needed to conduct CFIUS investigations. The Administration is concerned that provisions of the bill that provide CFIUS with additional statutory authority to collect evidence and require the attendance and testimony of witnesses and the production of documents would make the CFIUS process more adversarial and less effective.

The Administration believes its ability to protect national security would be enhanced by a statutory grant of authority to impose civil penalties for a breach of a mitigation agreement. This authority to seek civil penalties, which could be calibrated to the seriousness of the noncompliance, would be a useful and effective tool for enforcing those agreements.

Presidential Review and Decision

The Administration supports requiring the President to make the final decision on a case only when CFIUS recommends that a transaction be blocked or when CFIUS fails to reach a consensus after a second-stage investigation. Requiring Presidential action in a broader set of cases would undermine the President's ability to determine how best to exercise Executive Branch decision-making authority.

The Administration looks forward to working with Congress on these important issues.

OVERSEAS ATTACHÉ PROGRAM

Question. Overseas attachés work in tandem with the Office of International Affairs and the Office of Terrorism and Financial Intelligence, as well as the relevant U.S. Embassies, to build relationships with foreign officials and to work with local U.S. industry, market and agency representatives.

What are the main purposes of the overseas attaché program?

To what extent are they involved with your anti-terrorism program?

How many attachés do you currently have around the world?

You are in the process of expanding the program and we gave you additional funds in the recent 2007 CR to do it. How far do you intend to expand the program in 2007 and 2008?

What qualifications are you seeking in candidates to fill these jobs?

Answer. The attaché program is essential for several priorities, including those related to:

—Building Treasury's expertise on economic and financial sector issues and fostering stronger substantive dialogues that can advance U.S. Government objectives.

—Identifying policy or regulatory barriers to U.S. firms and exports, particularly in the area of financial services.

—Strengthening cooperation with other countries to implement U.N. resolutions and U.S. enforcement actions to prevent and punish money laundering, terrorism and proliferation financing, and other financial crimes.

—Coordinating closely with other U.S. agencies and multilateral donors (such as the IMF and World Bank) to advance economic growth and development. This is particularly important in countries with a large U.S. Government presence, such as Iraq and Afghanistan.

As of April 2007, Treasury has eight attachés in China, Japan, Southeast Asia (Singapore), Afghanistan, Iraq, Belgium, Brazil, and Egypt. We expect to place an attaché in India in the coming months. Treasury is planning to open another nine attaché posts during fiscal year 2007-fiscal year 2008, tentatively slated to include Abu Dhabi, Istanbul, Riyadh, Islamabad, Johannesburg, Mexico City, London, Jakarta, and Tel Aviv.

To fill these positions, Treasury has been seeking professionals who can represent Treasury effectively within the U.S. Embassy and with senior officials of their counterpart countries, enhancing the effectiveness of Treasury's policy engagement. These tasks require a variety of substantive and interpersonal skills, including those related to macroeconomic analysis, financial sector development, and money laundering and the financing of terrorism. The precise nature of the substantive expertise will vary by country. For example, in Japan knowledge of macroeconomic and financial sector issues in a mature economy is critical. In contrast, experience with emerging markets and development issues is more important in attaché posts such as Egypt and in Southeast Asia. In other posts, the principal focus will be on terrorist financing issues, putting a premium on familiarity with financial sector issues and U.S. Treasury authority to fight financial crimes.

ESTABLISHMENT OF DYNAMIC TAX OFFICE AT TREASURY

Question. In last year's budget request, Treasury requested $513,000 to set up a Dynamic Analysis Division within the Office of Tax Policy.

Are you making the same request in this year's budget?

Can you tell us how such an office would work and what its purpose would be?

Answer. The initial request to establish a Dynamic Analysis Division within the Office of Tax Policy was included in the President's 2007 budget request; however, due to the CR, the request was not enacted. A similar request is therefore included in this year's budget. If funded, Treasury would hire a director and several staff for the division. The purpose of the division, as the name suggests, would be to conduct dynamic analysis of tax proposals. Dynamic analysis incorporates a broad range of behavioral responses to tax changes and provides an estimate of how those tax changes affect aggregate labor supply, savings and national income in both the near term and the long run. This analysis would improve the policy making process by providing information to policy makers about the economic effects of tax proposals. Treasury already provides estimates of revenue and distributional effects of tax proposals, but does not normally provide estimates of the effects of tax proposals on national savings or output. Treasury's analysis will help inform and complement the type of dynamic analysis currently being done by the Joint Committee on Taxation and the Congressional Budget Office.

In analyzing the revenue effect of potential tax policy changes, Treasury routinely considers how taxpayers might respond to the changes, but does not consider how the overall economy might be affected in its official scoring of tax proposals. Dynamic scoring of tax proposals would take dynamic analysis a step further by estimating how the change in economic activity translates into changes in tax receipts. Under the current proposal, Treasury would commit to conducting dynamic analysis of major tax policy changes, but not to dynamic scoring. Treasury plans to continue to rely on their traditional approach for "official" estimates of the revenue effect of the tax proposals, and to present dynamic analyses as supplemental information.

PERSONALLY IDENTIFIABLE INFORMATION

Question. In the past year, there have been numerous incidents regarding the loss or theft of federal computers and disk drives at different agencies where the names and social security numbers of citizens may have been compromised. In one incident, VA reported the loss of a notebook computer that contained Personally Identifiable Information for 26 million veterans. Other incidents were reported by a number of federal departments.

What is the Department doing to protect Personally Identifiable Information?

Is the Department in compliance with the OMB recommendations on this? If not, what are its plans to become compliant and by when?

Answer. The protection of sensitive personal and taxpayer information is of critical importance to the Department as is our ability to fulfill the Department's responsibilities to our citizens.

The Department has an important obligation to exercise extraordinary diligence in handling Personally Identifiable Information entrusted to our care and is taking aggressive actions to avoid it being compromised. Towards protecting Personally Identifiable Information, approximately 90 percent of Treasury laptops, including 99 percent of IRS laptops, have been encrypted (in accordance with FIPS 140–2 encryption standards) including installation of an automatic full disk encryption solution. Additionally, some of the remaining 10 percent of Treasury laptops have limited encryption already installed (e.g., specific folder encryption.) We are planning for a 99 percent+ completion rate by the end of June. We are also working to provide enhanced protection to other portable IT devices, specifically including Blackberries, which contain Personally Identifiable Information.

Additionally, in response to recommendations of the President's Identity Theft Task Force and the Office of Management and Budget, Treasury is in the process of establishing a Personally Identifiable Information Risk Management Group (PIIRMG). The Department is currently identifying points of contact as well as membership consistent with those identified in the Task Force recommendations and anticipates the initial PIIRMG kick-off meeting in the coming weeks. The establishment of the PIIRMG is an important component of our risk management efforts in the area of Personally Identifiable Information, particularly as Treasury Bureaus establish the capability to assess any Personally Identifiable Information-related incident that may occur and make recommendations for corrective and risk-reduction action to the PIIRMG.

Following OMB's recent memorandum titled "Safeguarding Against and Responding to the Breach of Personally Identifiable Information," over the next 120 days

Treasury will review and reduce its current holdings of PII reduce them to the minimum necessary for the proper performance of a documented agency function. Treasury will also, within 120 days, review its use of social security numbers (SSN) in agency systems and programs to identify instances in which collection or use is superfluous, as well as establish a plan in which it will eliminate the unnecessary collection and use of SSN within eighteen months.

INFORMATION SECURITY

Question. The Inspector General has noted that the Department needs to improve its information security program and practices to achieve compliance with the Federal Information Security Management Act and OMB requirements. The Act, as you know, was meant to bolster computer and network security within the Federal Government and affiliated parties (such as government contractors) by mandating yearly audits. The IG's 2006 evaluation disclosed deficiencies that constitute substantial noncompliance with the Act.

What steps are you taking to come into compliance with that Act?

Answer. Providing adequate security for the Federal government's investment in information technology (IT) is a significant undertaking and the Department is working towards improving its posture in this area. Our on-going efforts include taking steps to refine systems inventory for completeness and consistency, issuing Treasury policy in support of FISMA requirements, and strengthening the process for security remediation efforts.

In the area of inventory management, the Department has defined the inventory of major information systems (including national security systems) operated by or under the control of the Department, as originally required by the Paperwork Reduction Act of 1995. As an indication of our progress, for the first time, in the OIG's 2006 FISMA evaluation, it was noted that "[a]ll agency systems were accounted for on the inventory." Furthermore, Treasury issued Department-wide guidance on major and minor systems to ensure a consistent Treasury-wide approach in compiling system inventories.

Treasury policy, in support of our FISMA compliance efforts, seeks to secure the information and information systems that support the operations and assets of Treasury, including those provided or managed by another agency, contractor, or other source on behalf of the Department. Clarifying guidance has been issued for contractor systems to ensure those systems are consistently and completely identified in the Department's systems inventory and that they comply with security requirements. Policy has also been issued to address acceptable system configuration requirements and to define our vulnerability management policy. Developing policy and ensuring compliance across the Department is an ongoing effort, but an area in which progress is being made.

In order to strengthen Treasury's remediation efforts, and come into compliance with FISMA, the Department is developing a process for planning, implementing, evaluating, and documenting remedial action (Plan of Actions & Milestones, or POA&M) to address any deficiencies in the information security policies, procedures, and practices. In 2006, our POA&M process was judged to be effective, a significant improvement from 2005. Lastly, the Department continues to work to make progress in improving the quality of the certification and accreditation of its systems, testing of security controls and contingency plans, incident reporting, and employee training on systems security. The President's 2008 budget request includes significant investments in information security, including $21 million for the IRS' Computer Security Incident Response Center and network infrastructure security.

Question. Secretary Paulson, I understand that the United States is currently negotiating an OECD convention called the Large Aircraft Sector Understanding, which deals with the financing terms of aircraft, and that the negotiations are near conclusion. However, I have heard from U.S. industry that they do not believe their concerns have been addressed in the context of the negotiations. I am advised that the U.S. industry has prepared a comprehensive text that outlines its major concerns.

Given that the health of the U.S. aerospace industry is critical to the economy, the national security and the technological base of the United States, I respectfully request that you meet with the industry group that prepared the report to discuss the negotiations, and that you and your team at Treasury carefully review the industry position before agreeing to critical provisions put forward by the EU, which could hinder the ability of American companies to compete.

Answer. The U.S. Government negotiating team, led by Treasury, has been in continuous contact with industry throughout the negotiating process. That process has been underway for over two years. We will continue to consult intensively before reaching a final agreement. Over the past two months, the Deputy Secretary, Under Secretary, and Assistant Secretary have all met with industry representatives to gather their views.

These consultations have occurred primarily through the Department of Commerce-led Aerospace Industry Trade Advisory Committee (ITAC) and the Aircraft Working Group (AWG—an international industry group for which Boeing serves as Vice Chairman). The AWG has met with OECD negotiators on a number of occasions, and has also provided formal written recommendations on the important competitive elements of an agreement. Treasury has followed appropriate procedures for reviewing the ITAC's recommendations, and the positions taken by the U.S. negotiators to date are in full accord with those recommendations.

Treasury officials and substantive experts met several times with key industry representatives, including meetings as recently as the week of April 16th. In these meetings, the detailed industry-recommended text was thoroughly examined point-by-point, and U.S. negotiators worked with this text in discussions with other negotiators at the OECD the week of April 23.

I can assure you that the provisions of this new agreement will ensure that U.S. industry will remain fully competitive. We will support an agreement that provides a level playing field for our exporters. The agreement will also sharply limit the ability of foreign governments to provide subsidized financing for their aerospace industries' exports. By limiting these subsidies, we will also limit subsidies that are currently provided to foreign airlines and that disadvantage our domestic airline industry, which does not have access to such subsidies.

QUESTIONS SUBMITTED BY SENATOR SAM BROWNBACK

Question. You've asked for some increases in your budget in the areas of Terrorism and Financial Intelligence and in the International economic policy area. Can you tell me a little bit about the Treasury's work in these areas and why these increases are important?

Answer. The Terrorism and Financial Intelligence and International economic policy areas budget increases reflect the Department of the Treasury's expanding mission in these areas.

Terrorism and Financial Intelligence

The Treasury, and the Office of Terrorism and Financial Intelligence, in particular, has requested additional resources to increase the implementation of strategies and employment of targeted financial measures to disrupt and dismantle the financial networks that support terrorism, WMD proliferation, and organized crime. Targeted financial measures developed since 9/11 to combat terrorist support networks can and should be used to disrupt and dismantle the networks that support other threats. These types of financial measures have proven effective, in part because they unleash market forces by highlighting the risks and encouraging prudent and responsible financial institutions to make the right decisions about the business in which they are engaged. Treasury uses designations strategically to disrupt specific sources, means, and mechanisms of terrorist financing, including radical ideologues, charities and other sources and conduits of terrorist financing and support.

The fiscal year 2008 President's budget requests additional analysts and production officers for the Office of Intelligence and Analysis to support Treasury's ability to address emerging national security threats. This request will allow Treasury to establish a permanent intelligence production structure, an essential component to the timely and accurate production of intelligence information. In addition to this initiative, OIA is seeking additional funds and personnel to expand the Department's ability to coordinate on terrorist-financing and WMD proliferation matters, and to improve OIA's working relationships with foreign intelligence services.

The Office of Terrorist Financing and Financial Crimes, the policy and outreach apparatus for TFI, develops and implements strategies, policies and initiatives to identify and address vulnerabilities in the United States and the international financial system and to disrupt and dismantle terrorist and WMD proliferation financial networks. Treasury's request would give the Office of Terrorist Financing and Financial Crimes (TFFC) additional resources to devote specific policy advisors to critical regions in the Western Hemisphere, Africa, and the Middle East-South Asia nexus. Countries in these regions continue to provide a financial base for terrorists. Additional advisors would allow TFFC to meet multiple strategic objectives, including enhancing the Treasury Department's ability to disrupt terrorist financial and support networks and building the capacity of foreign governments to combat terrorist financing. Without adequate full-time staff dedicated to these region-specific issues, U.S. strategic priorities and specific Treasury responsibilities cannot be addressed in a comprehensive or strategic manner.

TFFC has also requested additional resources to increase our development of strategies toward rogue regimes and their corresponding networks. North Korea, Syria, and Iran pose a constant threat to U.S. national security, and Treasury is tasked with applying all appropriate financial measures towards pressuring these rogue regimes, isolating them from the international financial system, and disrupting their financial networks.

Treasury's request would fund additional policy advisors to cover North Korea, Syria, and Iran and would allow the Treasury Department to leverage tactical successes to develop ongoing strategic approaches to bring additional financial pressures. These positions would become the focal point for interagency efforts to bring financial pressures to bear against these rogue regimes, enhancing Treasury's ability to meet its strategic objectives and U.S. strategic priorities. In addition to achieving sustained, focused pressure on Iranian, Syrian, and North Korean WMD proliferation finance, criminal and terrorist financing activities, Treasury would establish future strategies on emerging regimes of concern (e.g., Venezuela). These positions would also provide TFFC the ability to provide support and guidance to senior NSC officials dealing with the relevant issues. This initiative is consistent and in support of Executive Orders 13338 and 13382 and Section 311 of the USA PATRIOT Act.

The Office of Foreign Assets Control (OFAC), an office within TFI, is responsible for administering and enforcing economic sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international narcotics traffickers and those engaged in activities related to the proliferation of weapons of mass destruction. Treasury's request would also give OFAC additional resources to implement U.S. economic sanctions policy. OFAC is committed to combating terrorist networks and state sponsors of terrorism. New Executive Orders with respect to Sudan and Syria were issued in 2006, and the Administration is also extensively engaged with respect to Iran. Each new Executive Order and/or OFAC designation of terrorists and their financial networks brings with it increasing demands on OFAC's enforcement, licensing, compliance and administrative support components. Additional resources in these areas are requested to match the increased tempo of new Executive Orders and Treasury designations.

In addition, the WMD sanctions program is a Presidential national security priority and these resources will be used to strengthen OFAC's ability to track, identify and designate financiers and other supporters of WMD proliferation. Publicizing the designations, and assigning resources to enable OFAC to engage in outreach to the private sector and with government agencies, will greatly assist the Treasury Department in effectively isolating financiers and facilitators of WMD proliferation from the United States and international commercial communities. This request will also provide OFAC with additional resources to generally expand its enforcement capacity in support of investigation and blocking activities, which are critical to the enforcement of sanctions.

International Affairs

With the increasing importance of global economics and dynamics, the Department of the Treasury is increasing its international focus. First, the Executive Direction area is seeking additional positions and funding to effectively manage the U.S.-China Strategic Economic Dialogue (SED) and maximize the likelihood of progress on issues of concern to the United States such as the Chinese currency, energy and the environment, and intellectual property rights. The SED reflects the growing relationship between the economies of the United States and China, and is structured to provide a focused framework for addressing such issues of concern.

Additionally, the Department of the Treasury, in its role as chair of the interagency Committee on Foreign Investment in the United States (CFIUS), has seen its responsibilities increase exponentially. CFIUS is responsible for monitoring and evaluating the impact of foreign investment in the United States, including for national security implications. In addition, CFIUS is the President's designee under Exon-Florio. In that capacity, CFIUS conducts in-depth national security investigations of transactions notified to CFIUS under Exon-Florio. The 2008 request includes additional resources to match the growth in transactions submitted for CFIUS review.

The increase in CFIUS activity is described below:

—CFIUS investigated 113 transactions in 2006—a 74 percent increase over the number of transactions for 2005 (65) and 85 percent more than the annual average (61). This increase can be attributed to a rise in cross-border merger and acquisition activity, an increase in international investor awareness of CFIUS and its role, and higher scrutiny of the security concerns posed by acquisitions of U.S. businesses by foreign-owned companies.

—The percentage of transactions that proceeded to a 45-day second-stage investigation also increased significantly last year, to seven from two in 2005. Second-stage investigations require significant involvement of very high-level officials and commitment of staff resources.

—CFIUS member agencies negotiate security agreements with the parties to a transaction in order to mitigate national security concerns raised by the transaction. In 2006 alone, 16 agreements were negotiated, which was 35 percent of all CFIUS-related agreements negotiated since 1997. Last year CFIUS also prepared two reports on notified transactions recommending to the President how the case should be resolved. This is the largest number since 1990, when four such reports were sent. Each mitigation agreement and report to the President requires significant resources.

—CFIUS anticipates an even greater number of transactions to be filed in 2007 and plans to continue to conduct thorough reviews in the context of an open investment policy. We have received approximately 65 filings and negotiated five mitigation agreements to date in 2007.

—CFIUS has also increased its reporting to Congress, providing the relevant committees with information pertaining to every case once deliberative action has concluded. We also provide periodic briefings to Congressional oversight committees on all cases for which deliberative action has concluded.

As you well know, the Department of the Treasury received funds in fiscal year 2007 to expand its overseas presence through the establishment of Treasury attachés in countries such as Iraq, China and Afghanistan. Funding is requested for the full fiscal year 2008 cost and FTE realization from this fiscal year 2007 initiative.

The attaché program is essential for several priorities, including those related to:

—Building Treasury's expertise on economic and financial sector issues and fostering stronger substantive dialogues that can advance U.S. Government objectives.

—Identifying policy or regulatory barriers to U.S. firms and exports, particularly in the area of financial services.

—Strengthening cooperation with other countries to implement U.N. resolutions and United States enforcement actions to prevent and punish money laundering, the financing of terrorism, and other financial crimes.

—Coordinating closely with other United States agencies and multilateral institutions (such as the IMF and World Bank) to advance economic growth and development. This is particularly important with places with a large U.S. Government presence, such as Iraq and Afghanistan.

Question. Please explain how you plan to block U.S. commercial bank transactions connected to the government of Sudan?

Answer. The United States has maintained comprehensive economic sanctions with respect to Sudan since 1997. Under Executive Order 13067 of November 3, 1997, implemented through the Sudanese Sanctions Regulations, 31 C.F.R. Part 538, the United States government already requires U.S. persons to block all property and interests in property of the Government of Sudan. All major U.S. banks, including their foreign branches, and the U.S. offices of foreign banks, have programs in place to detect and block such transactions as they are processed. Treasury is working actively to enhance implementation and compliance to ensure that it is as responsive as possible.

On October 13, 2006, the President issued Executive Order 13412 to implement the Darfur Peace and Accountability Act of 2006. E.O. 13412 continues the country-wide blocking of the Government of Sudan's property and interests in property and prohibits all transactions by U.S. persons relating to Sudan's petroleum and petrochemical industries. E.O. 13412 also removes the regional government of Southern Sudan from the definition of Government of Sudan.

In addition to these targeted sanctions, OFAC administers a targeted sanctions program against persons in connection with the conflict in Sudan's Darfur region. This program stems from Executive Order 13400 of April 26, 2006, in which the President ordered the blocking of four individuals listed in the Annex to the order, and of additional persons who meet the specified criteria set forth in the order.

Question. Last year, the Department identified the following as the three most immediate challenges for TFI: (1) the need for additional resources to more aggressively pursue core objectives, (2) leveraging its authorities most effectively to deal with Iran and Syria, and (3) building the information technology systems necessary to effectively and efficiently carry out TFI's mission. Could you give us an update of where Treasury stands in meeting these challenges?

Answer. Treasury has taken significant steps forward in addressing key national security threats, particularly terrorism and WMD proliferation, but there is still important work to be done on these and other emerging threats. The requested resources will improve Treasury's ability to expand its coverage of current national security threats and allow the Department to adapt to new emerging threats.

The fiscal year 2008 President's budget requests additional analysts and production officers to support Treasury's ability to address emerging national security threats. In fiscal year 2005, when OIA was created, the Office focused on developing a process for exploiting current intelligence. In fiscal year 2006, OIA improved its strategic analytic capability and developed a research program, which was coordinated with IC partners. In the current fiscal year, OIA is concentrating on building breadth and depth to its analytic cadre, so that OIA can better address some of the national security threats that have developed in the past year. Still, to fulfill the intent of Congress and Treasury leadership when they created the Office, OIA must increase the systemic analysis of issues underlying key national security threats. This request will also allow Treasury to establish a permanent intelligence production structure, an essential component to the timely and accurate production of intelligence information. In addition to this initiative, OIA is seeking additional funds and personnel to expand the Department's ability to coordinate on terrorist-financing and WMD proliferation matters, and to improve OIA's working relationships with foreign intelligence services.

The fiscal year 2008 President's budget requests additional resources to support the Office of Foreign Assets Control (OFAC), an office within TFI,which is responsible for administering and enforcing economic sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international narcotics traffickers and those engaged in activities related to the proliferation of weapons of mass destruction. The fiscal year 2008 request would give OFAC additional resources to implement U.S. economic sanctions policy combating terrorist networks and state sponsors of terrorism. New Executive Orders with respect to Sudan and Syria were issued in 2006, and the Administration is also extensively engaged with respect to Iran. Each new Executive Order and/or OFAC designation of terrorists and their financial networks brings with it increasing demands on OFAC's enforcement, licensing, compliance and administrative support components. Additional resources in these areas are requested to match the increased tempo of new Executive Orders and Treasury designations. In addition, resources are requested to strengthen OFAC's ability to track, identify and designate financiers and other supporters of WMD proliferation. The WMD sanctions program is a Presidential national security priority. Publicizing the designations, and assigning resources to work with the U.S. public will greatly assist the Treasury Department in effectively isolating financiers and other supporters of WMD proliferation.

The Treasury Department has drawn upon its full range of authorities and influence to combat threats including WMD proliferation and terrorism. The strategies we have employed to combat the threats posed by Iran and Syria are good examples of the ways in which financial authorities are effective in dealing with state sponsors of terrorism.

Iran

Formal Measures

Treasury has acted both formally and informally to combat the threat emanating from Iran, which includes a threat to the international financial system. Iran's dangerous activities, including the sponsorship of terrorism and the pursuit of a nuclear weapons program, rely on access to financial networks and financial systems. Our efforts to attack the financial roots of these threats work to simultaneously protect our own financial institutions as well as the international financial system.

First, it must be noted that the United States has a longstanding country sanctions program against Iran. These commercial and financial sanctions, which are administered by the Treasury's Office of Foreign Assets Control (OFAC), prohibit U.S. persons from engaging in a wide variety of trade and financial transactions with Iran or the Government of Iran. They prohibit most trade in goods and services between the United States and Iran, and any post-May 7, 1995, investments by U.S. persons in Iran. U.S. persons are also prohibited from facilitating transactions via third-country persons that they could not engage in themselves.

Beyond these general country sanctions, we are relying more and more on "targeted" measures directed at specific individuals, key members of the government, front companies, and financial institutions. These measures are aimed at specific actors engaged in specific conduct. Some require financial institutions to freeze funds and close the accounts of designated actors, denying them access to the traditional financial system. At times, the action includes bans on travel or arms transfers, which further confine and isolate those engaged in illicit activities. To maximize the effect, we try to apply these measures in concert with others. Whenever possible, we act with a partner or a group of allied countries.

The United States is using various types of targeted measures to combat Iran's pursuit of nuclear weapons and development of ballistic missiles, as well as its support for terrorism. First, while under our general Iran country sanctions program Iranian financial institutions are prohibited from directly accessing the U.S. financial system, they are permitted to do so indirectly through a third-country bank for authorized payments, including payments to another third-country bank. In September 2006, we cut off one of the largest Iranian state-owned banks, Bank Saderat, from any access, including this indirect, or "u-turn," access to the U.S. financial system. This bank, which has 25 foreign branch offices, is used by the Government of Iran to transfer money to terrorist organizations. Iran has used Saderat to transfer money to Hizballah. Iran and Hizballah also use it to transfer money to E.U.-designated terrorist groups, such as Hamas, the PFLP–GC, and the Palestinian Islamic Jihad. Since 2001, for example, a Hizballah-controlled organization received $50 million directly from Iran through Saderat.

We have also acted against 19 entities and individuals supporting Iran's WMD and missile programs, including another Iranian bank, Bank Sepah, using Executive Order 13382. That Executive Order, signed by President Bush in June of 2005, authorizes the Treasury and State Departments to target key nodes of WMD and missile proliferation networks, including their suppliers and financiers, in the same way we target terrorists and their supporters. A designation under E.O. 13382 effectively cuts the target entity or individual off from access to the U.S. financial and commercial systems and puts the international community on notice about the threat they pose to global security as a result of their activities. Specifically, such a designation freezes any assets that the target may have under U.S. jurisdiction and prohibits U.S. persons from doing business with it.

Senior Treasury officials have traveled all over the world, sharing a U.S. list of Iran-related designations with foreign government counterparts and private sector representatives, and stressing the importance of ensuring that these proliferators are not able to access the international financial system. Our list of targeted proliferators is incorporated into the compliance systems at major financial institutions worldwide, who have little appetite for the business of proliferation firms and who also need to be mindful of U.S. measures given their ties to the U.S. financial system.

The Treasury's designation of Iran's state-owned Bank Sepah under E.O. 13382 in January of this year is particularly significant because it makes it more difficult for the regime to hide behind its banks to support its proliferation activities. Like certain other Iranian banks and entities, Bank Sepah has engaged in a range of deceptive practices in an effort to avoid detection, including requesting that other financial institutions take its name off of transactions when processing them in the international financial system.

Informal Measures

Aside from these "formal" actions, the Treasury has engaged in unprecedented, high-level outreach to the international private sector, meeting with more than 40 banks worldwide to discuss the threat Iran poses to the international financial system and to their institutions. Secretary Paulson kicked off this effort last fall in Singapore, in discussions during the annual IMF/World Bank meetings, where he met with the executives from major banks throughout Europe, the Middle East, and Asia. Secretary Paulson, Deputy Secretary Kimmitt, Under Secretary for Terrorism and Financial Intelligence Stuart Levey, and Assistant Secretary for Terrorist Financing and Financial Crimes Patrick O'Brien have continued to engage with these institutions abroad, as well as in Washington and New York.

Through this outreach, we have shared information about Iran's deceptive financial behavior and raised awareness about the high financial and reputational risk associated with doing business with Iran. Our use of targeted measures has aided this effort by allowing us to highlight specific threats. We share common interests and objectives with the financial community when it comes to dealing with threats. Financial institutions want to identify and avoid dangerous or risky customers who could harm their reputations and business. And we want to isolate those actors and prevent them from abusing the financial system.

By partnering with the private sector, including by sharing information and concerns with financial institutions, we are increasingly seeing less of a tendency to work around sanctions.

As evidence of Iran's deceptive practices has mounted, financial institutions and other companies worldwide have begun to reevaluate their business relationships with Tehran. Many leading financial institutions have either scaled back dramatically or even terminated their Iran-related business entirely. They have done so of their own accord, many concluding that they did not wish to be the banker for a regime that deliberately conceals the nature of its dangerous and illicit business. Many global financial institutions have indicated that they have limited their exposure to Iranian business. A number of them have cut off Iranian business in dollars, but have not yet done so in other currencies. It is unclear whether this is just a first step toward phasing out the business entirely. Regardless of the currency, the core risk with Iranian business—that you simply cannot be sure that the party with whom you are dealing is not connected to some form of illicit activity—remains the same. Scaling back dollar-business reduces, but does not eliminate, the risk.

As further evidence of the change in tide, a number of foreign banks are refusing to issue new letters of credit to Iranian businesses. And in early 2006, the OECD raised the risk rating of Iran, reflecting this shift in perceptions and sending a message to those institutions that have not yet reconsidered their stance.

Additionally, many other companies have scaled back on their investments or projects in Iran, concluding that the risks of expanding operations in the country are too great. Multinational corporations have held back from investing in Iran, including limiting investment in Iran's oil field development. These companies have done their risk analyses, and they have realized that the Iranian regime's behavior makes it impossible to know what lies ahead in terms of Iran's future and stability.

Syria

As in Iran, we have taken a combination of steps to address Syria's problematic behavior and the threats posed by Syria. Under Executive Order 13338, Treasury is applying targeted financial sanctions that provide for the blocking of the assets of individuals and entities that, among other things, contribute to Syria's support of international terrorism, military or security presence in Lebanon, pursuit of weapons of mass destruction and missile programs, and undermining of U.S. and international efforts in Iraq. E.O. 13399 provides for the blocking of individuals and entities who were involved in the assassination of the former Lebanese Prime Minister Rafik Hariri or certain other bombings or assassination attempts in Lebanon since October 1, 2004

In addition, four Syrian entities are subject to an asset freeze under the WMD proliferation sanctions program that was established in June 2005. The Scientific Studies and Research Centre (SSRC) was named by the President in the annex of Executive Order 13382. SSRC is the Syrian government agency responsible for developing and producing non-conventional weapons and the missiles to deliver them. While it has a civilian research function, SSRC's activities focus substantively on the acquisition of biological and chemical weapons. The three additional entities meet the criteria for designation under E.O. 13382 because they are subordinates of SSRC.

Second, we took action pursuant to the USA PATRIOT Act's Section 311 to protect the U.S. financial system against the Commercial Bank of Syria (CBS). Criminals and terrorists have utilized CBS to facilitate or promote money laundering and terrorist financing, including the laundering of proceeds from the illicit sale of Iraqi oil and the channeling of funds to terrorists and terrorist financiers. In March 2006, Treasury issued a final rule, pursuant to Section 311, designating CBS as a primary money laundering concern. This additional step required U.S. financial institutions to close correspondent bank accounts with CBS, which essentially halted U.S. business with CBS.

As a result of these U.S. enforcement measures against Syria-based entities engaging in illicit financial activity, international financial institutions have reassessed their business relationships with Syria and a number of Syrian entities.

Responding to the need for information technology systems, funding for Enterprise Content Management (ECM) will be used to implement a pilot enterprise-wide ECM project for the Department, initially meeting the critical and urgent business needs of the Office of Foreign Assets Contract (OFAC) and the Financial Crimes Enforcement Network (FinCEN). The project, which is under the oversight of the Department's Chief Information Officer, will be designed to meet Department-wide ECM requirements, thereby minimizing duplication of effort and infrastructure investments by capitalizing on Department and government-wide efforts.

Treasury is also currently in the midst of a multi-year project to upgrade the Treasury Foreign Intelligence Network (TFIN), which is the Department's system authorized for both Top Secret and Sensitive Compartmented Information. Treasury has made significant progress in stabilizing the system and as a result, Treasury analysts are already using IT tools like Intellipedia and classified Instant Messaging to better cooperate with counterparts across the IC.

Treasury's CIO is currently modernizing TFIN to enhance the analytical work flow and add additional analytic tools. In fiscal year 2008, the Department has requested $3 million for operations and maintenance, to ensure the system is maintained and upgraded as necessary.

Question. With the establishment of TFI, how are intelligence activities coordinated with other federal agencies and the Office of the Director of National Intelligence?

Answer. The Department of the Treasury's analytic efforts are guided by its research and production plan, which was created to ensure that its analytic priorities were consistent with those of the DNI, the National Security Council (NSC), and the Treasury Department. This plan is also extensively coordinated throughout the IC. Because of this coordination and through other bilateral exchanges, opportunities for joint projects with IC partners have grown since OIA was created in 2005.

—In early 2006, Treasury and the Federal Bureau of Investigation (FBI) worked in concert to preserve the assets of Toledo-based NGO KindHearts, as the NGO and its officers faced allegations of terrorism finance.

—Treasury co-founded and co-leads, with the Department of Defense, the Iraq Threat Finance Cell (ITFC) in Baghdad, Iraq. The ITFC's mission is to enhance the collection, analysis, and dissemination of intelligence to combat the financing of terrorist and insurgent groups in Iraq. ITFC participating agencies include other members of the IC, as well as FBI, Secret Service, and IRS Criminal Investigations.

—Treasury collaborated with other IC agencies to identify and map Iranian Weapons of Mass Destruction (WMD) proliferation networks, while supporting the targeting of WMD proliferation entities for Treasury action.

Question. What progress has been made on cross-border currency transactions, wire transfers, and effective oversight with other countries?

Answer. Systems for the collection, storage, processing, analysis, and dissemination of cross-border electronic funds transfers are in place. Both the Australian and Canadian governments, through their financial intelligence units, have imposed cross-border electronic funds transfer reporting requirements on their financial services industries.

Canada

The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) is Canada's financial intelligence unit.

FINTRAC first required the reporting of cross-border electronic funds transfers ("EFT" reporting) in June 2002. Initially, FINTRAC required only reports of international funds transfers made using certain SWIFT messages. Effective March 31, 2003, FINTRAC expanded the international EFT reporting requirement to cover all forms of international EFT regardless of system or message format. FINTRAC receives almost all of its international EFT reports electronically; FINTRAC's regulations permit for paper filing where the reporting institution can certify that they lack the capability to file electronically, but FINTRAC officials noted that this rarely happens.

To facilitate the electronic filing of these reports, FINTRAC established a "batch file transfer format" that informs financial institutions of the appropriate report content and form. In turn, reporting institutions must implement their own systems for converting the institutions' non-SWIFT data to the proper format prior to submission. For non-SWIFT EFTs, FINTRAC has also developed an online form that is generally used by smaller institutions. For both SWIFT and Non-SWIFT messages, FINTRAC has established minimum mandatory data fields (17 fields for outgoing SWIFT messages; 8 fields for incoming SWIFT messages; 11 fields for both outgoing and incoming Non-SWIFT messages) that must be included in the report (again, FINTRAC dictates the format of the batch submission, but distinguishes between mandatory fields and those fields).[1]

More than 300,000 entities and persons are potentially subject to the EFT reporting requirement in Canada, but many do not conduct business that reaches the thresholds in the law and thus, need not report. In addition, not all types of regulated institutions are currently required to report. However, the Department of Finance has issued a public consultation paper recommending that Parliament amend existing law to require all regulated entities to report cross-border EFTs. As noted above, FINTRAC permits reporting institutions to report by batch file and by single report through either a web-based interface or client software distributed by

[1] See http://www.fintrac.gc.ca/publications/guide/Guide8/81__e.asp.

FINTRAC. Currently 56 entities report via the batch process, with the others using the online reporting mechanism.

In total, FINTRAC receives approximately 590,000 international EFT transaction records per month.

—In 2003–04, FINTRAC received 2.7 million SWIFT EFT reports and 3.9 million Non-SWIFT EFT Reports.

—In 2004–05, FINTRAC received 3 million SWIFT EFT reports and 4.1 million Non-SWIFT EFT Reports.

—60 percent of all the FINTRAC reports are submitted by banks.

—FINTRAC's international EFT data store contains approximately 15.6 million records.

Australia

The Australian Transaction Reports and Analysis Centre (AUSTRAC) is the financial intelligence unit of the Australian government.

AUSTRAC first required the reporting of cross-border electronic funds transfers (International Funds Transfer Instructions or "IFTI" reporting) in 1992.[2] Generally, AUSTRAC requires the institutions "who are senders of IFTIs transmitted out of Australia; or who are receivers of IFTIs transmitted into Australia" submit reports of those transactions.

AUSTRAC accepts IFTI reports in one of two formats. First, AUSTRAC accepts reports containing properly formatted SWIFT instruction messages from those institutions that use the SWIFT system. Second, AUSTRAC established a batch file transfer format and requires the reporting institutions to implement their own systems for converting the institutions' non-SWIFT data to the proper format prior to submission. For both SWIFT and Non-SWIFT messages, AUSTRAC has established minimum mandatory data fields that must be included in the report.

AUSTRAC permits reporting institutions to report by batch file and by single report through a web-based interface operated by AUSTRAC. This interface enables institutions to upload prepared files automatically, provides an interface for the manual upload of prepared batch files, and provides a form for extremely low volume reporting institutions to submit their data. In addition, AUSTRAC developed and distributes to financial institutions a Microsoft Excel macro that will convert certain electronic records to the prescribed data format for upload to the AUSTRAC systems. AUSTRAC officials told us that the largest four institutions in Australia account for approximately 80 percent of the IFTI reporting, while a second tier of approximately 20 institutions account for the majority of the remaining reports.

In total, AUSTRAC receives approximately 9 to 10 million IFTI records per year.

—In 2003–04, AUSTRAC received approximately 4 million inbound and approximately 4.5 million outbound IFTI reports.

—In 2004–05, AUSTRAC received 4.2 million inbound IFTI reports and approximately 5.5 million outbound IFTI reports.

—The most recent figures reveal that in the course of a year, approximately 78 percent of the IFTI reports are in SWIFT format and 22 percent in non-SWIFT format.

—AUSTRAC's data store contains approximately 70 million records dating from 1995 to present; 55 million of those are IFTI reports.

Question. I understand that the United States is near concluding negotiations on the "Large Aircraft Sector Understanding," dealing with the financing terms of aircraft. I have been informed that the U.S. industry does not believe their concerns have been addressed in the context of the negotiations. They are troubled that agreeing to the provision put forward by the EU could hinder their ability to compete. Would you be willing to meet with the industry group to discuss their concerns?

Answer. The United States Government negotiating team, led by Treasury, has been in continuous contact with industry throughout the negotiating process. That process has been underway for over two years. We will continue to consult intensively before reaching a final agreement. Over the past two months, the Deputy Secretary, Under Secretary, and Assistant Secretary have all met with industry representatives to gather their views.

These consultations have occurred primarily through the Department of Commerce-led Aerospace Industry Trade Advisory Committee (ITAC) and the Aircraft

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[2] The IFTI reporting provisions are set out in section 3 and sections 17B to 17F of the FTR Act. The prescribed details in relation to IFTIs are contained in Regulation 11AA of the Financial Transaction Reports Regulations 1990 (FTR Regulations); see also AUSTRAC Information Circular No. 2, available at http://www.austrac.gov.au/text/guidelines/circulars/pdfs/AIC%2002%20%20International%20Funds%20Transfer%20Instructions.pdf.

Working Group (AWG—an international industry group for which Boeing serves as Vice Chairman). The AWG has met with OECD negotiators on a number of occasions, and has also provided formal written recommendations on the important competitive elements of an agreement. Treasury has followed appropriate procedures for reviewing the ITAC's recommendations, and the positions taken by the U.S. negotiators to date are in full accord with those recommendations.

Treasury officials and substantive experts met several times with key industry representatives, including meetings as recently as the week of April 16th. In these meetings, the detailed industry-recommended text was thoroughly examined point-by-point, and U.S. negotiators worked with this text in discussions with other negotiators at the OECD the week of April 23.

I can assure you that the provisions of this new agreement will ensure that U.S. industry will remain fully competitive. We will not support any agreement that does not provide a completely level playing field for our exporters. The agreement will also sharply limit the ability of foreign governments to provide subsidized financing for their aerospace industries' exports. By limiting these subsidies, we will also limit subsidies that are currently provided to foreign airlines and that disadvantage our domestic airline industry, which does not have access to such subsidies.

Question. Treasury's Office of Intelligence Analysis was established in fiscal year 2005. Since that time, how has it contributed to overall intelligence collection?

Answer. The Treasury's Office of Intelligence Analysis (OIA) is primarily an analytic component. Through its membership in the Intelligence Community (IC), OIA has also been instrumental in driving collection on financial issues in the intelligence requirements process. At the national level, OIA created and filled a dedicated collection requirements officer position. This individual ensures that Treasury equities in financial, economic, enforcement, and other areas, are reflected in national intelligence priorities and collection requirements. At the working level, OIA analysts actively provide feedback and direction on disseminated intelligence reports to ensure that information relevant to Treasury's mission is collected. OIA analysts regularly engage with counterparts in collecting offices across the IC.

Treasury also is the program office for the Terrorist Financing Tracking Program (TFTP). Using its authorities, Treasury has access to certain very limited and targeted data streams that provide information about the financial activities of known terrorists.

Additionally, Treasury co-founded and co-leads, with the Department of Defense, the Iraq Threat Finance Cell (ITFC) in Baghdad, Iraq. The ITFC's mission is to enhance the collection, analysis, and dissemination of intelligence to combat the financing of terrorist and insurgent groups in Iraq. ITFC participating agencies include other members of the IC, as well as FBI, Secret Service, and IRS Criminal Investigations.

Question. What key ways is your Department proposing to employ to close the "tax gap?" You stated in a Finance Committee hearing that this is not a pot of gold. How big is the gap and what will it cost to close it?

Answer. The tax gap is the difference between the amount of tax imposed on taxpayers for a given year and the amount that is paid voluntarily and timely. The tax gap represents, in dollar terms, the annual amount of noncompliance with our tax laws. Based in part on the results of a National Research Program (NRP) analysis of approximately 46,000 individual tax returns for Tax Year 2001, the IRS has estimated that the gross tax gap for Tax Year 2001 was $345 billion. After collections and late payments, the net tax gap for that year is estimated to be $290 billion. Although the IRS will never be able to audit its way out of the tax gap, considerable progress has been made in improving compliance as indicated by growth in enforcement revenues in recent years.

In September 2006, the Treasury Department released a document titled "A Comprehensive Strategy for Reducing the Tax Gap." The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance. See http://www.treasury.gov/press/releases/reports/otptaxgapstrategy%20final.pdf for a copy of this report. This strategy includes detailed legislative proposals, along with new initiatives to reduce opportunities for evasion, a commitment to research, continual improvements in technology, enhanced enforcement programs and taxpayer service programs, increased outreach and education and enhanced coordination and partnering with stakeholders.

The tax compliance strategy is reflected in the President's fiscal year 2008 budget request which includes sixteen legislative proposals to begin to address the tax gap with minimum impact on taxpayers. These proposals include requiring basis reporting on sales of securities; information reporting on merchant payment card reimbursements; increased information reporting for certain government payments for property and services; and implementing standards to clarify when employee leasing companies can be held liable for their clients' Federal Employment taxes.

In addition, the fiscal year 2008 budget request provides:

—$205 million to expand enforcement activities, a majority of which will go to improve compliance among small business and self-employed (SB/SE) individual taxpayers. It will also fund implementation of the legislative proposals described above.

—$20 million to enhance taxpayer service, including expansion of volunteer tax assistance and research to determine the effect of service on taxpayer compliance.

—$41 million for research that will update estimates of reporting compliance. Unlike the past, the IRS will conduct an annual study of compliance among 1040 filers that will provide fresh compliance data each year, and by combining samples over several years will provide a regular update to the larger sample size needed to keep the IRS' targeting systems and compliance estimates up to date.

—$143 million for information technology that includes upgrades for critical infrastructure to prevent business operation disruptions and upgrades of IT security.

The IRS and Treasury Department will continue to work with OMB on future funding needs to support the implementation of its tax gap strategy.

Question. If we simplified our tax code with, for example, a flat income tax, what effect would there be on revenue receipts and revenue collection?

Answer. There are at least three potential effects on receipts from substituting a flat income tax for our current income tax. First, initial receipts under a flat tax could differ from those under the current income tax due to estimation error. There is some flat tax rate that initially would bring in the same amount of revenue as our current income tax. Depending on how much the flat tax base differs from the tax base of the current income tax, however, there may be more or less significant error in estimating the revenue-neutral flat tax rate. This error could be positive or negative. Second, a greatly simplified income tax could reduce the so-called "tax gap." Taxpayers who fail to understand the highly complex provisions of the current tax code are unlikely to be compliant with those provisions. While this noncompliance could result in overpayment or underpayment of taxes, there is strong belief that, on net, it results in underpayment. The complexity of our current tax code also is thought to provide opportunities for some taxpayers to intentionally underpay their taxes. Hence, a dramatically simplified income tax could result in a higher level of tax compliance, contributing to revenue collections. Third, under a truly flat income tax—that is, a tax with a single tax rate—revenues likely would grow more slowly than under our current income tax. As real incomes increase, our current progressive income tax taxes the higher real incomes at higher effective tax rates, resulting in tax receipt growth that exceeds income growth. Under a true flat tax, tax receipt growth would be more likely to equal, or nearly equal, income growth.

SUBCOMMITTEE RECESS

Senator DURBIN. The subcommittee hearing is recessed.

Thank you.

[Whereupon, at 5:01 p.m., Wednesday, March 28, the subcommittee was recessed, to reconvene subject to the call of the Chair.]