Department of the Treasury Exit Memo

Secretary Jacob J. Lew

Cabinet Exit Memo | January 5, 2017

Introduction

The Department of the Treasury (Treasury) is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States. This role encompasses a broad range of activities, such as advising the President on economic and financial issues, encouraging sustainable economic growth, and fostering improved governance in financial institutions.

Treasury's mission was challenged like few times before in our nation's history during the 2008 financial crisis. As few of us can forget, signs of trouble first emerged in the housing market, which set off a cascade of shocks in 2007 and 2008, including the collapse of Bear Stearns and Lehman Brothers, the freezing of credit markets, and the loss of trillions of dollars of wealth held by Americans in their homes, other assets, and businesses. By the time President Obama took office, the United States was in the midst of the worst recession since the Great Depression. The economy was shrinking at its fastest rate in 50 years and shedding more than 800,000 private-sector jobs per month. Unemployment peaked at 10 percent in 2009, a level not seen in over 25 years. The auto industry, an embodiment of American ingenuity and economic strength, was teetering on the edge of collapse; the deficit had hit a post-World War II high; and homes in neighborhoods across the United States faced foreclosure.

Though the financial crisis was perhaps the most pressing challenge the country faced in 2008, it was far from the only one. Health care spending was on an unsustainable path, and millions of Americans lived in fear of facing a significant medical problem without insurance. Middle-class and working family incomes had stagnated for much of the previous three decades. Wealth disparities had grown to levels not seen since the 1920s. And after two major wars in the Middle East and strained relationships in many parts of the world, the standing of the United States around the world was in need of significant repair.

We have come a long way as a country since 2008. In the following pages, I will recount the Administration's record of progress, with a specific focus on the role Treasury has played. I will also articulate a vision for the future, and recommend steps to be taken in the coming years to make progress towards that vision. Finally, I will end with some personal reflections.

Eight Years of Progress

Economic Recovery

Over the eight years since President Obama took office amidst the worst financial crisis of our lifetimes, we have seen a sustained economic recovery and a significant decline in the federal budget deficit. We have cut the unemployment rate in half. Our economy is more than 10 percent larger than its pre-recession peak. U.S. businesses have added a total of 15.6 million jobs since private-sector job growth turned positive in early 2010. Household incomes are rising, with 2015 seeing the fastest one-year growth since the Census Bureau began reporting on household income in 1967. And our financial system is more stable, safe, and resilient, providing the critical underpinnings for broad-based, inclusive, long-term growth.

There are many factors that explain why the United States was able to bounce back so strongly from the recession. First and foremost, I credit the resilience of the American people. In addition, our policy response to the crisis was immediate and robust. Led by my predecessor, Treasury Secretary Tim Geithner, policymakers put in place a wide-ranging strategy to restore economic growth, unlock credit, and return private capital to the financial system, thereby providing broad and vital support to the economy. In February 2009, just 28 days after taking office, President Obama signed the American Recovery and Reinvestment Act, which provided powerful fiscal stimulus that resulted in a less severe recession and stronger recovery than we otherwise would have seen.

Investments made through our Troubled Asset Relief Program (TARP) provided stability to our financial system, and the Automotive Industry Financing Program helped prevent the collapse of the U.S. auto industry. TARP also included housing initiatives that helped millions of struggling homeowners avoid foreclosure and lower their monthly payments. These efforts bolstered the housing market and strengthened consumer finances more broadly. And funds expended under TARP have been repaid in full, at a profit to taxpayers: in total, TARP invested $412 billion in financial institutions, large and small, during the financial crisis, and as of October 2016, these investments have returned $442 billion total cash back to taxpayers.

Critically, we also acted quickly to reform our financial system, working with Congress to enact the most far-reaching and comprehensive set of financial reforms since the Great Depression: the Dodd-Frank Wall Street Reform and Consumer Protection Act. Wall Street Reform transformed the way the financial system operates, and Treasury and the financial regulators have continued to work together since its passage to implement important reforms such as the Volcker Rule, risk retention, and resolution planning for large, complex financial institutions. Because of these efforts, our system today is more stable, more transparent, and more consumer-focused. Wall Street Reform also created the Financial Stability Oversight Council, a body that looks across the entire financial system to identify future threats to financial stability, and the Consumer Financial Protection Bureau, a watchdog agency that is working hard to protect Americans from unfair, deceptive, or abusive financial practices.

The progress we have made on implementing reform has resulted in a safer, stronger, and more stable American financial system—one better positioned to support growth rather than work against it, more likely for consumers to get fair treatment in their interactions with financial institutions, and less prone to major failures of financial firms that can harm Americans on Main Street. This progress must be sustained through continued follow-through, to avoid allowing a return to the recklessness and abuse that predated the worst global financial crisis of the last 80 years.

A More Inclusive Economy

Beyond working to bring our economy back from the brink and to spur growth, we also undertook efforts to ensure that more citizens have a fair shot at sharing in our nation's prosperity. One of the Administration's most significant achievements was the 2010 passage of the Affordable Care Act (ACA), which extended health insurance to millions of Americans who had not previously had it, allowed young adults to stay on the health plans of their parents, barred insurance companies from denying coverage to people with preexisting conditions, and strengthened Medicare's solvency. Once the legislation was signed into law, Treasury implemented the law's many new tax provisions. Beyond the ACA, the Administration made a number of other key changes to the tax code that has made our tax system significantly fairer and more equitable.

Through programs like the Community Development Financial Institution Fund and *my*RA, and through extensive stakeholder engagement, Treasury has worked to promote access to the financial system for underserved and vulnerable populations. We also successfully worked with Congress to pass bipartisan legislation to enable Puerto Rico to undergo a financial restructuring. With continued commitment from policymakers in both the Commonwealth and the United States, this legislation will begin to put Puerto Rico on a fiscally sustainable path so that the 3.5 million Americans living there are not denied essential services and economic opportunity.

Leading in the Global Economy

As we put into place the financial regulatory framework to prevent future crises in the United States, we also led the international response to the crisis. We worked through the G-20 to help mobilize $5 trillion in fiscal stimulus, expand the resources of the international financial institutions by $1 trillion, and establish new institutions like the Financial Stability Board to prevent future crises. Our approach elevated the G-20 as the premier platform for international economic cooperation and put in place a demonstrated mechanism for international response.

Following the financial crisis, many countries turned to policies of fiscal austerity, and Treasury vigorously advocated for a more balanced use of policy levers. Over the next several years, Treasury engaged closely with our partners and through the G-20 and other multilateral bodies to emphasize the need for short-term growth and longer-term structural reforms to put the global economy on stronger footing. Through our sustained engagement, we achieved a number of commitments from the G-20, including moving away from austerity-only fiscal policy and avoiding competitive currency devaluation.

We have used the G-20 to advance a global growth agenda, and the U.S.-China Strategic & Economic Dialogue to foster increased bilateral economic coordination and engagement with China. Our sustained engagement with China has allowed us to exert positive pressure on Chinese exchange rate policy—whereas China once intervened in foreign exchange markets to drive down the value of its currency, in the past year, we have seen China intervene to *prevent* a rapid depreciation in the renminbi, which would have had negative consequences for the Chinese and global economies. Treasury also worked to solidify U.S. leadership by modernizing the international economic architecture to ensure that it would remain relevant in a changing world. In particular, securing the passage of International Monetary Fund (IMF) quota reform sustained U.S. leadership on the global stage. Our leadership in the IMF in turn enabled us to work through it to promote policies that supported U.S. economic and security objectives, such as economic stability in Ukraine and Greece.

Promoting a Safer World

Treasury has also continued to use its unique financial capabilities to address a variety of national security and foreign policy threats posed by terrorists, criminals and other bad actors. To address the changing threat posed by terrorism, including the threat posed by ISIL, we have worked with our international partners to deny terrorist financiers, fundraisers, and facilitators access to the international financial system with financial measures and targeted actions.

Treasury's sanctions against Iran played a critical role in forcing Iran to the table to negotiate a deal that cuts off the country's pathways to a nuclear weapon. To hold Russia accountable for its aggression in eastern Ukraine and its occupation and attempted annexation of Crimea, we imposed sanctions that led to tighter financial conditions, weaker confidence, and lower investment in Russia. We also secured new domestic and multilateral sanctions measures against North Korea in the face of Pyongyang's continued provocative behavior with regard to nuclear weapons and weapons of mass destruction. All the while, we have worked to craft a cohesive vision for the use of sanctions, in which sanctions are informed by financial intelligence, strategically designed, and implemented with our public and private partners to focus pressure on bad actors and create clear incentives to end malign behavior, while limiting collateral impact.

In the face of emerging cyber threats, we have also made significant progress in coordinating cybersecurity efforts among financial regulators and the private sector, both domestically and internationally, to improve the financial sector's resilience and to establish best practices for industry and government.

A Vision for the Future

Looking across the next five years, 10 years, and beyond, I see four major goals that mirror the progress above. Treasury should focus on: (i) continuing to promote more inclusive growth; (ii) moving from recovery to long-term fiscal health, (iii) remaining a leader in the global economy; and (iv) adjusting to the new threats in our world. Each of these goals brings with it major challenges that we must collectively overcome in order to reach them.

Continuing to Promote Inclusive Growth

Through the work of this Administration, the U.S. economy is growing again. But working families have not shared fully in the benefits of economic growth over the past decade, and there is evidence that our society has undergone structural changes that have fundamentally altered the basic social compact. It is crucial that the next Administration builds on the work already done to ensure that our prosperity is broadly shared. There are many aspects to inclusive growth, including: investing in infrastructure to create good middle-class jobs and lay the foundation for future growth, giving workers a stronger voice, enacting progressive tax policies, making quality education more available and affordable, and investing in retraining programs for those who have lost their jobs. One component most directly within Treasury's purview is increasing access to the financial system; currently, many low-income and minority families are effectively locked out, operating without a credit card or banking history. Finding creative ways to increase access to the financial system—such as fostering new technologies—will help individuals and families transfer money and make payments safely and affordably. Financial inclusion allows people to manage life's unexpected financial shocks, build long-term financial security, and take advantage of economic opportunities, like starting a business. Our inclusive growth agenda should not, however, be limited to domestic issues: more than 2.6 billion people live in poverty around the world, and more than two billion people rely solely on cash transactions. Moving underserved populations from a cash economy to formal banking not only increases their economic opportunity but also strengthens our ability to combat illicit and dangerous finance.

Moving from Recovery to Long Term Fiscal Health

The actions of this Administration, and the economic recovery those actions helped support, have sharply reduced deficits since 2009. However, both the Administration and the Congressional Budget Office project that, absent any changes in policy, the deficit will rise steadily over the next decade and beyond. Thus, while the actions of this Administration have put the country on a solid fiscal footing today, we must also focus on the long-term fiscal health of our nation.

In recent years, the Administration has proposed a combination of smart investments and policy reforms that would keep the deficit under three percent of GDP for the next 10 years and nearly eliminate the fiscal gap over the next 25 years. Tax reform to curb inefficient tax breaks for the wealthy, close loopholes, and reform the taxation of capital income and financial institutions would make the tax system fairer and lower the deficit. Comprehensive immigration reform would boost labor force participation, productivity, and ultimately growth, directly addressing key fiscal challenges. Continued focus on health policy to further improve health care quality and control cost growth remains critical. This policy vision shows that investments in growth and opportunity are fully compatible with putting the nation's finances on a strong and sustainable path. It also shows that responsible deficit reduction can be achieved without endangering vital support to poor Americans or undermining commitments to seniors and workers.

Under President Obama's leadership, there has been substantial economic and fiscal progress, showing what is possible when strategic investment to grow the economy is paired with smart reforms that address the true drivers of long-term fiscal challenges. While there is some scope for additional borrowing to finance smart investments in the next few years, ever-increasing borrowing is not sustainable as a long-run strategy, particularly when used to finance spending that does not generate higher growth or improvements for the middle class and in the case of deficit-increasing tax cuts, which deepen income and wealth disparities that are already a serious concern. Instead, the long-term fiscal health of the nation depends on smart investments in the middle class, tax reforms that close loopholes for the wealthy and ensure that everyone plays by the same set of rules, comprehensive immigration reform, and health reforms that build on our progress to date without sacrificing coverage or quality.

Remaining a Leader in the Global Economy

The United States must continue its long history of international economic leadership. Such leadership benefits American workers and families and enables the United States to project its values abroad to achieve its larger foreign policy objectives. Of course, the world has changed since the creation of our international financial architecture after World War II, and we must change with it. Perhaps somewhat counterintuitively, our influence internationally will increase if we share the benefits, as well as the responsibilities, of managing the global economic and financial system with emerging economies, such as China. Our influence, however, cannot be sustained if we either back away or insist on protecting the status quo.

But we face a host of challenges. Our relationship with China is one of the most important in the world. While we have made much progress over the past eight years, the degree to which China is willing to takes the steps necessary to follow through on commitments to reorient its economy toward more sustainable growth, open up to foreign businesses, and be a partner in global governance, remains to be seen. As we saw from the example of Chinese exchange rate policy, engagement between the United States and China is an important means of maintaining pressure for China to implement policies that are necessary for China's own medium and long-term economic health and to create a level playing field for the world economy.

The UK's decision to leave the European Union sent shockwaves through Europe and the world, and we must closely monitor the situation and continue to argue for the benefits of continued integration post-Brexit. Japan's economy faces the ongoing challenges of an aging population and high public debt hampering the government's ability to foster growth. We must also keep a watchful eye on emerging economies and the unique challenges they face. In particular, in recent years, we have made progress in our relations with Latin America, particularly with Mexico and Argentina, and we should build on that progress.

Adjusting to the New Threats in Our World

With the rise of state-sponsored and lone wolf terrorism, rogue nations, and international strongmen, we must address the reality that we live in a dangerous world. Making it safer means using every tool available—including the financial tools available to Treasury—to defeat and degrade terrorist organizations like ISIL. We must continue to leverage our ability to impose crippling sanctions on states and individuals to change behavior. We must seek to eliminate the proliferation of nuclear weapons. Cyber attacks on our financial system represent a real threat to our economic and national security, and maintaining vigilant and coordinated efforts to keep pace with and respond to these threats has been and will remain a crucial piece of Treasury's work. And we must recognize global climate change for the economic and existential threat that it is and band together with the rest of the world to avert catastrophe.

How to Make Our Vision a Reality

How do we accomplish the goals laid out above? To be sure, there are a host of paths policymakers might take to do so, but I believe the following steps, which range from specific policy prescriptions to more general advice, are the most immediate.

Infrastructure Spending

Moving forward, we must redouble our efforts to make investments in our country's transportation infrastructure, which help create middle-class jobs in the short term and drive broad-based economic growth in the long term. Indeed, by fixing our aging roads, bridges, and ports, we will help lay a foundation for widely shared economic expansion. The President's business tax reform framework, discussed in more detail below, would generate substantial one-time revenues to fund new infrastructure investments. Paying for these investments by taxing overseas business profits would both be fiscally responsible and would help fix the perception that our tax system is not a level playing field.

Continuing to come up with fresh, new ways to deploy capital will help the country achieve these goals. Effective partnerships between government and the private sector can play an important role in developing innovative solutions that efficiently leverage resources. And taking advantage of historically low interest rates to fund high-return public investments is simply smart fiscal policy. This Administration has long advocated for the creation of a national infrastructure bank, which would provide critical financing and technical support to foster public-private partnerships in U.S. infrastructure and establish a predictable source of long-term financing that would allow U.S. infrastructure to be consistently improved.

Business Tax Reform

Over the last eight years, Congress and the Administration have taken important steps to make the tax code fairer, support working families, and roll back unnecessary and unaffordable tax cuts for high-income families. In addition, using its administrative tools, the Administration has made substantial progress over the past eight years in combatting abusive tax practices. However, our business tax system remains in need of reform. As I have emphasized repeatedly throughout my time as Treasury Secretary, only Congress can enact business tax reform, which is necessary to remove incentives for businesses to relocate overseas, raise one-time revenues to promote infrastructure spending, and simplify tax compliance for smaller businesses.

President Obama's proposed plan for business tax reform sets out a framework for modernizing our business tax system. Among other elements, it would prevent companies from using excessive leverage in the United States to reduce their tax burden, impose a minimum tax abroad to help fight the global race to the bottom, impose a one-time tax on unrepatriated foreign profits, and reform the taxation of financial and insurance industry products. It also would close loopholes and special credits and deductions to lower rates without shifting the tax burden to individuals. Enacting such a plan would enhance our competitiveness and create an environment in which business rather than tax considerations drive decision-making. The President's framework is also fiscally responsible, ensuring that business tax reform does not add to deficits over the long-term. I am hopeful that this framework will help to equip the new Congress to take responsible action on business tax reform.

Housing Finance Reform

Fixing our housing finance system remains the major unfinished work of post-financial crisis reform. Though the housing market has made significant strides thanks to efforts on the part of the Administration to help struggling homeowners, stabilize the housing finance system, and restore broader economic growth, many homeowners and neighborhoods continue to struggle. Fannie Mae and Freddie Mac remain in conservatorship and continue to rely on taxpayer support. Only legislation can comprehensively address the ongoing shortcomings of the housing finance system. A starting point for such legislation should be the principles President Obama laid out in 2013, which stressed a clearly-defined role for the government to promote broad access to consumer-friendly mortgages in good times and bad. While private capital should bear the majority of the risks in mortgage lending, reform also must provide more American households with greater and more sustainable access to affordable homes to rent or own.

Global Economic Integration

Global economic integration, including high-standards trade, leads to better economic outcomes than isolation and protectionism. High-standard trade agreements such as the Trans-Pacific Partnership can expand U.S. economic growth, open markets for American exports, and strengthen labor and environmental safeguards so that American workers can compete on a level playing field. But economic uncertainty, both domestically and abroad, threatens this framework. Whether driven by trade, technological advances, or the changing structure of the markets for labor and capital, these anxieties are real and deeply felt. In order to continue to enjoy the benefits of an integrated world, we need to focus on policies that address the real issues of inequality, such as slowing wage growth and increasing disparities in pay, to ensure that the benefits of trade are broadly felt.

Strengthening the rules, alone, is not enough. To preserve this important engine of economic growth and international integration the United States and other advanced economies must also design and implement policies—including fiscal and tax policies—that advance the cause of inclusive, sustainable, and broad-based growth. Not all countries have the fiscal space sufficient to meet these needs, but after years of urging by the United States, policies of austerity are one-by-one giving way to policies designed to grow demand and improve incomes. The United States must continue to be an active voice in the global discussion of these issues.

The United States must also maintain its leadership in the international financial architecture and ensure that the U.S.-led international financial system is adapting to best preserve U.S. interest in a changing world. This includes continued governance reforms of the IMF and multilateral development banks to reflect a changing world. Clear global rules create opportunities and incentives for innovation, invest, and work, which are critical to the United States and drive economic progress in other regions of the world.

Continued Engagement with Challenging Partners

Just as global economic integration has fueled economic growth, that integration—and our economic strength—provides us with additional tools to advance our priorities on the international stage. We should continue to use these tools judiciously to maintain pressure on those countries that take aggressive and destabilizing actions, such as Russia and North Korea, and provide sanctions relief when the targeted malign behavior changes, as with Iran and Burma. And, as we chart new courses with other countries, such as Cuba, we should be mindful of how we can use our economic tools to create the conditions for a changed relationship.

We must always take care to avoid the overuse of sanctions, particularly our most unilateral tools like secondary sanctions that extend to non-U.S. persons. If we overuse these powerful tools, we risk lessening their impact when they are most needed and ultimately threaten our central role in the global financial system.

Looking Forward with Optimism

We have learned the hard way that deadlock does not produce good results—government shutdowns and near default on our debt cost the United States both economically and in standing around the world. It did not work in the 1990s, and it did not work over these past eight years.

What has worked is finding opportunities in the sometimes quiet periods when bipartisan cooperation can lead to honorable compromise. In recent years, we have seen that targeted budget agreements could pave the way for more orderly and economically beneficial outcomes. We have seen that, on issues like creating a path forward for Puerto Rico and multi-year funding for our surface transportation programs, bipartisan compromise is still possible.

But there is much more that requires this kind of progress. Treasury plays a critical role in finding areas where bipartisan solutions are possible. In a period when many thought little could be accomplished legislatively, we reached agreement on IMF Quota Reform, an approach to deal with Puerto Rico, and a permanent extension of expansions to the earned income tax credit and child tax credits that will reduce the extent or severity of poverty for millions of families with children. We have also used our existing authorities to limit corporate tax inversions, shed greater light on beneficial ownership to limit tax avoidance, realize tax parity for same-sex spouses, and opened relations with Cuba. And we have used our sanctions authorities to bring Iran to the negotiating table and limit the resources available to terrorist regimes and groups.

I am proud of the record we have built over the past eight years. But during calmer economic times, policy makers are often tempted to roll back regulations, weaken reforms, and reduce oversight. I hope that future policymakers will take careful stock of the successes of this Administration as they consider the next steps forward. I remain an optimist about America's future and wish the next team entrusted with responsibility for governing much success as it tackles the many challenges that remain and the new challenges that will present themselves over the coming years.