

THE BROOKINGS INSTITUTION
THE STATE OF THE U.S. ECONOMY
A CONVERSATION WITH TREASURY SECRETARY JACOB LEW

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Welcome:

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The Brookings Institution

Keynote Address:

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Secretary
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Moderator:

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P R O C E E D I N G S

MR. GAYER: Good morning, everybody. Welcome to the Brookings Institution. My name is Ted Gayer. I am the vice president and director of the Economic Studies program here at Brookings.

I just want to start with a little bit of housekeeping. If I could just ask the end of the event if everybody would stay in their seat as the Secretary departs, that would be greatly appreciated.

So it's my great honor and privilege today to introduce the country's 76th Secretary of the Treasury, Jack Lew. As you can see from our new and improved signs -- we never forget our signs -- this event is hosted by our Hutchins Center on Fiscal and Monetary Policy, which was launched almost exactly one year ago today and is led by my colleague, David Wessel, who will be moderating today's discussion.

The Hutchins Center mission is to improve the quality and public understanding of fiscal and monetary policy. This event clearly fits squarely within that mission. Fiscal policy, of course, is a key instrument to securing our nation's goal of building shared prosperity for all Americans. And in particular, yesterday, the President mentioned a bunch of things, but a lot of it alluded to changes in our tax code in order to help our middle class, and that's something I'm sure the Secretary will elaborate on today.

Secretary Lew has spent much of his career in government is widely respected for his thoughtfulness and deep expertise on the budget and the economy. His expertise and knowledge no doubt proved invaluable to all of us as he steered the nation through many debt limit negotiations, although I'm sure he'd be happy to have those experiences in the past and not in the future. Enough brinksmanship on that.

Secretary Lew was confirmed by the U.S. Senate in February of 2013.

He was previously the White House chief of staff and he was the director of the Office of Management and Budget, both in the Clinton administration and the Obama administration. In my household, I don't know how many of you know this, but among my three sons he's also very well known for his kind of loopy, crazy signature. Something I did check last night as we were watching the State of the Union, my son's assignment, he watched his first State of the Union yesterday, and we were talking about your signature. And we checked a \$5 bill and your signature has -- I guess it's a prerequisite for the job, it is now legible, I would say. (Laughter)

He's also known, while I'm talking about household dynamics, he's also known with my wife as the guy who keeps hiring all of my great colleagues over to Treasury, which I've forgiven him since they are doing great work over there, although I do miss them.

We're delighted that he's here today to share his views on the state of the U.S. economy and on the administration's goals for the upcoming year. Following Secretary Lew's remarks, David Wessel will lead a conversation with the Secretary, and we'll take questions from the crowd.

So with that, Mr. Secretary, thank you for being here today and the podium is yours. (Applause)

SECRETARY LEW: Thank you very much for that kind introduction and thanks to David and the Hutchins Center for hosting us this morning and for all of you for being here today. And thank you for the talent that we rely on every day.

Brookings has long been at the center of important public policy discussions and it's been a source of innovative solutions to help create jobs and grow the economy. It's a pleasure to be with you this morning to discuss a very important subject.

Last night in the State of the Union the President put forward a series of proposals to keep America's resurgent economy on track, to build on the progress we've made, and help more Americans share in our economic gains through rising wages, higher incomes, and a growing middle class. The roadmap the President laid out includes strategies to make it easier for families to buy a home, for students to attend college without amassing unaffordable debt, for workers to find good jobs in high-tech manufacturing, for working families to care for a sick child or an aging parent, for businesses and consumers to defend themselves against cyber attacks, and for states and cities to rebuild their infrastructure and expand their broadband networks.

In last night's address the President also made it clear that we need to knock down barriers on things like paying for child care, saving for college, and building a secure retirement, so that the middle class can get ahead even as we revamp our business tax system, so that businesses of all size can compete in today's global economy, making our nation a more attractive place for companies to locate, grow, and create the kind of high-paying jobs that support families.

Just prior to the State of the Union the President outlined a key part of his vision to raise wages and incomes and strengthen the standing of working families. It includes a new strategy to simplify our complex tax code, make it fair, and by eliminating some of the biggest loopholes. And it uses the savings to responsibly pay for investments that we need to help middle class families get ahead and grow the economy.

Today I want to spend some time discussing America's business tax system and why we need to fix it to promote long-term growth and broad-based prosperity. Let me say at the outset that our entire federal tax code needs to be overhauled. It's been almost 30 years since we last rewrote it and since then the tax system has become heavily burdened by loopholes and inefficiencies.

I was proud to be involved in the negotiations on Capitol Hill that resulted in the last major reforms to our tax system in 1986, when we demonstrated that working together across party lines to do hard things is good for our country. While our views on individual tax reform may be far apart, there's a broad set of business tax reforms on which we should be able to agree. And I continue to believe that the best way to achieve reform today is to start with pro-growth business tax reform that protects and strengthens the middle class, lowers rates, simplifies the system, levels the playing field, and eliminates unfair and inefficient loopholes.

When we make the switch to a smarter business tax system there will also be one-time revenue during the transition, and we can use some of that to create jobs rebuilding our roads, repairing our tunnels, and renovating our airports. The fact is there is a growing bipartisan consensus in Washington on how to achieve business tax reform, and we have a unique opportunity now to get this done.

Before turning to business tax reform I want to talk a bit about the strengthening economic recovery. Over the past five years, our private sector has created more than 11 million jobs. That's the longest streak of private sector job growth in our nation's history. Last year alone, American businesses created nearly 3 million jobs, more private sector jobs than any calendar year since 1997. And the month of December, the private sector added 240,000 new jobs. The unemployment rate is now 5.6 percent, the lowest rate in 6-1/2 years.

At the same time, GDP posted strong gains in the second and third quarters last year, and many private forecasters project above-trend economic growth to continue. Just this week the International Monetary Fund revised its 2015 Economic Outlook and revised its projection for the United States upwards while lowering its forecasts for most other countries.

Our overall growth has been supported by increases in household wealth, a gradually improving housing market, a growing manufacturing sector, and a flourishing auto industry. With the Affordable Care Act in place millions of Americans no longer have to worry that an unexpected illness will throw them into bankruptcy and people with preexisting conditions are now guaranteed access to health insurance.

Thanks to Wall Street reform consumers have a watchdog in place while our financial system is stronger and more resilient. And now key agencies responsible for putting in place financial reform have increased funding to do their important work.

In conjunction with the President's all-of-the-above energy strategy we're safely developing American-made energy and we're now the world's leading producer of petroleum and natural gas.

Finally, because of the economic expansion and the tough choices that we've made in recent years, the federal government's financial condition has significantly improved and our budget deficit has been cut by two-thirds.

As I travel to other countries advocating for American workers and businesses, my counterparts often remark at how much better the United States has recovered and they try to learn from the steps that we've taken to turn around the U.S. economy. It's important to remember that this recovery is not an accident, but rather the result of the determination of the American people, the resilience of our businesses, and policy choices made by President Obama, the prior administration, Congress, and the Federal Reserve.

Despite this unmistakable progress, there's more work to do to make sure that we sustain our economic growth and that prosperity is more broadly shared. As part of that effort the President is putting forward business tax reform to help fuel economic growth, encourage businesses to create good, high-paying jobs in America,

and expand opportunities so our nation's economic gains build a strong middle class.

It's been almost three years since the President laid out his framework for sweeping business tax reform. Making sure the system works for everybody is as urgent today as it was then. And this year this is an area where members of both parties and the administration can work together to make progress for the American people.

On paper we have one of the highest corporate income tax rates in the world. But in practice there's a wide disparity in effective corporate tax rates. Some corporations pay little or no income tax at all while others pay the highest rate in the developed world. Even worse, our tax system allows American companies to shift profits overseas to avoid paying U.S. taxes and actually drives businesses to look for ways to move jobs and their tax home, at least on paper, out of the United States to countries with lower tax rates.

Over time our tax code has become increasingly loaded down special interest loopholes, deductions, and assorted tax subsidies. Some were good ideas whose time has now passed. Others were special interest giveaways from the beginning. The end result is a system rife with industry-specific breaks and widely disparate effective tax rates from one sector to the next, often providing incentives that do not reflect what our economy needs today.

For instance, oil and gas producers are rewarded with a number of special interest tax breaks that unfairly reduce the taxes of oil companies far below what other industries, like retail and manufacturing, pay on their earnings. Yet even with all these loopholes, the current tax system makes it too hard for businesses to launch, grow, and investment in the United States. It's too hard for businesses to create the middle class jobs our country needs and it's too hard for U.S. businesses to compete with companies' headquarters overseas.

Moreover, our business tax system is far too complicated, particularly for small businesses. One estimate suggests that a small business on average devotes hundreds of hours plus spends thousands of dollars to comply with the tax code. We can and must reduce this burden.

Our business tax system actually skews business decisions in ways that makes it harder for the economy to grow. Too many investment decisions are shaped by tax considerations when they should be driven by what will best enhance productivity and growth. Our tax code should favor the best businesses that create the most economic value, not those that are best at taking advantage of tax deductions.

The choice between debt accumulation or reduction, between investments in real estate or manufacturing should not be driven by tax planning. And when those decisions are driven by tax planning, it hurts growth and America's working families. When our system rewards businesses for having the best lobbyists or most creative accountant it shifts resources away from the core mission of growing the economy and creating jobs.

For example, the tax system has become so distorted that in some tax haven countries American multinational corporations report foreign profits that are several times larger than the entire economic output of those nations. This does not reflect the reality of the economic situation and it erodes both our tax base and confidence in the fairness of our tax system.

Last year, we saw how our broken tax system drives businesses to engage in highly unpopular transactions to get out of paying taxes. We saw a spike in the number of companies pursuing corporate inversions and we saw the public outrage that followed. An inversion takes place when a U.S. company buys a foreign company and declares it's no longer an American-based business. For many firms these deals are

little more than a tax avoidance scheme because renouncing U.S. citizenship allows them to lower their tax bills. I've consistently said that while inversions may be legal, they're wrong. But unfortunately, we have a tax code that encourages these decisions and we need to fix the tax code so companies will neither have the incentive nor the ability to invert simply to avoid taxes.

To be clear, cross-border mergers done for genuine business reasons make companies more efficient and productive. In a global economy we're better off when businesses are free to investment across borders and we benefit greatly from foreign companies choosing the United States as a destination for investment. But it's a very different case when mergers with foreign companies are really tax avoidance plans.

The United States is still the best place for so many companies to do business. Our rule of law, our intellectual property rights, our innovative and entrepreneurial culture and skilled workforce are unparalleled. Many companies that invert want to take advantage of U.S. infrastructure, education, and rule of law, but avoid paying their fair share of taxes, which only shifts the tax burden to others. This damages our country's finances and it's not fair because small businesses and middle class families end up paying more of the tax bills.

That's why the administration acted in September, to help level the playing field and make sure everybody plays by the same rules. We made it harder for companies to complete an inversion if they keep most of their business in the United States and eliminated certain techniques inverted companies used to avoid paying U.S. taxes. And these measures are making a difference. They stripped away some of the economic benefit of inversions and since they were announced we've seen a decline in the pace of these transactions and some deals were abandoned entirely.

While our action was important and it helped, it is not a complete

solution. It's a short-term response to one symptom of a dysfunctional tax system. The real answer is business tax reform that addresses the root cause of this problem. It eliminates the loophole for good and closes the door on other wasteful and inefficient loopholes that make our tax system unfair, uncompetitive, and overly complicated. And this can only be done through legislation.

The President's plan meets this test. It's a carefully constructed plan and it provides the basis for winning bipartisan support. To that end, I look forward to continuing conversations with Senators Hatch and Wyden, Representatives Ryan and Levin to make progress on reform.

There's a great deal of overlap between the President's framework and recent Republican proposals, including the one advanced by the former chairman of the Ways and Means Committee, former Representative David Camp. And like that plan, the President's proposal would use temporary revenue created by tax reform to rebuild our nation's roads, bridges, pipes, and ports.

We know from the past experience that switching to a new tax system will generate one-time transition revenues. The President's plan would use a portion of this temporary revenue to pay for long-delayed, one-time investments to upgrade our infrastructure, helping to address the funding gap we face to meet our long-term transportation, water, and electricity needs. And it will create a good manufacturing and construction job base to help local economic activity right away. Rebuilding America's core infrastructure will have the long-term benefit of making America a more attractive place to invest and do business so that our economy is stronger not just today, but for the future.

If we fail to meet our nation's infrastructure needs we're going to pay a heavy price: fewer jobs both now and in the future; a reduction in quality of life from

longer commute times, water main breaks, pollution, and power outages; and a rise in prices for goods and services that will damage small businesses and take a bite out of the salaries of middle class workers.

And we need to be very careful with how we use one-time revenues. We must not blow a hole in the budget by using one-time revenues to finance permanent spending on new items or to provide permanent tax cuts. Instead, we should use these one-time revenues to make responsible one-time investments in our nation's infrastructure.

Let me now turn to the specific components of the President's framework for reform. The President's proposal for a new business tax system has five pillars that represent an attempt to chart a bipartisan path forward.

First, we need to lower rates and close wasteful loopholes. This will make our business tax system competitive, fundamentally fair, and fiscally responsible. The President's plan eliminates dozens of tax breaks and loopholes and, without adding to our deficits, reduces the current top corporate tax rate from 35 percent to 28 percent. This rate is in line with our trading partners and it will help encourage investment in the United States.

As we broaden the tax base, we can also create more certainty and make the system simpler and more efficient. And we believe there is bipartisan support to move forward on this.

Second, we need to build on the resurgence of manufacturing in the United States. A vibrant U.S. manufacturing sector is fundamental to our capacity to remain innovative and competitive, and it's an important source of good-paying jobs for Americans workers. That's why the President's plan makes it even more attractive for manufacturers to build and expand here rather than overseas. It lowers tax rates for

domestic manufacturing to 25 percent and it takes manufacturing incentives, including the Research and Experimentation Tax Credit, and makes them permanent.

The Research and Experimentation Tax Credit jumpstarts private investment in research and technology, and it propels innovations that spark new jobs, new industries, and new breakthroughs in engineering and production. And this is another area of broad bipartisan support.

Third, Democrats and Republicans alike want to fix our backward international tax rules and root out the parts of the system that encourage companies to shift income and investment overseas. The international tax system is often looked at in terms of either what is known as a territorial system in which a company located in a particular country only pays taxes on income earned in that country or a system like that of the United States in which that company must pay taxes on worldwide income regardless of the country where it's earned.

The President's proposal strikes a sensible balance and would move us towards a more hybrid system. What that means is we would create a new minimum tax on foreign earnings and make it simpler for a business to bring income back to the United States. It would also tighten the rules so that companies cannot use accounting techniques to avoid paying taxes, such as shifting profits to low-tax countries.

Moreover, the President's strategy eliminates tax deductions that reward companies when they shut down operations in the United States and relocated abroad, and it provides tax breaks for companies that bring production back to the United States. With these changes in place we can help encourage investment in the United States. The hybrid structure that we propose has also been adopted by some Republican tax proposals and, again, should be an area where we can find bipartisan consensus.

Fourth, we all want to simplify and reduce taxes for small businesses:

our nation's mom-and-pop stores, startups, high-growth firms, and entrepreneurs. Truth is small businesses are a vital source of innovation, jobs, and growth. Small businesses embody the American principle that if you work hard and act responsibly you can succeed. These are businesses that we rely on to provide community stability, but they're also the ones that take the risks that lead to new technologies and new industries.

A few facts tell the whole story. Small businesses employ half of our nation's workforce and generate almost half of the nation's GDP. And that's why we're making sure that small businesses will be able to flourish, and that's a central part of our economic strategy.

Since the President came into office we've extended new tax benefits to small business, supported lending to tens of thousands of small businesses, and reformed our patent laws so inventions can get to the market sooner. While these steps have helped, we need to do more to strengthen small businesses and given them the confident to pursue long-term investments and hire for the future.

The President's business tax reform plan does that by making tax filing easier for small firms and entrepreneurs and by allowing many more to use the cash method of accounting, which is the same commonsense way most think about their own profitability.

In addition, the President's plan would allow a small business to annually expense up to \$1 million in investments. These permanent changes would free small business owners and entrepreneurs to direct more of their earnings toward expanding and hiring, and less to complying with a complicated tax code. And by giving small business owners certainty on their taxes it will free them to plan ahead and to innovate and invest.

Finally, we want to fix our broken tax code and increase investment in a

way that maintains current revenues. In other words, reform should be revenue-neutral in the short and long run. We've come a long way and our federal budget deficits have been falling rapidly. Independent forecasters project that over the 10-year budget window and under the President's policies our deficits will remain at a sustainable level relative to GDP.

But we can only afford to cut business tax rates substantially if we eliminate loopholes and use these savings to avoid an explosion of future deficits. Lower rates have to be paired with eliminating loopholes and deductions. And any business tax breaks that are made permanent, including so-called extenders that are currently reauthorized year after year, should be paid for with revenues that offset the expense.

Keep in mind loopholes, credits, and subsidies and forms of tax expenditures. They're spending that's done through the tax code. And because they represent lost tax revenue, we all help foot the bill for these expenditures. Of course, there are tax expenditures that make sense and that need to be protected, like the new markets tax credit, expensing for small business, and the Research and Experimentation Tax Credit. But these tax incentives cost money and need to be paid for to maintain adequate revenue levels.

And we cannot apply a double standard, as some have proposed, where we permanently extend business provisions without paying for them, without permanently extending critical improvements to the Earned Income Tax Credit, the child tax credit, and college credits that help working families at the same time.

Since Congress reconvened a few weeks ago, the House of Representatives changed the way the costs of some legislation will be calculated, directing scorekeepers to use what's known as dynamic scoring. We think this is unwise given the uncertainty involved in dynamic scoring, the assumptions that have to be made,

and the unequal treatment of tax cuts versus pro-growth investments funded through annual appropriations.

While there may be different opinions on how to estimate the effects of legislation, no matter what barometer you use, in the end nobody should want to blow a hole in our budget. We have to act responsibly and look at the cost of tax breaks and loopholes with a clear eye and make sure legislation can meet the first test of being fiscally responsible.

Finally, we'll need to hear the voices that support broadening the base to lower rates. Many, especially those in the business community, express interest in business tax reform and say they're for cutting loopholes and subsidies until they realize that a deduction or write-off that they like has to be pared back.

And we also know that many who will lose loopholes and tax breaks will fight hard for the status quo. It's important that we also hear from everyone else who agrees that a simpler tax code without loopholes and more competitive rates will help drive economic growth and job creation.

The fact is achieving a simpler, more sensible system that better harnesses the talent and skills of all Americans is going to require change and some sacrifice. The benefits of reform, though, will be shared broadly through greater job growth and economic activity.

Let me close by saying the message from the American people over the last few weeks and months has been clear. They want their leaders in Washington to find common ground, to compromise, and to get things done. And I believe that message has been received.

The Murray-Ryan agreement created a framework that showed we can work through the differences to find a path forward. And the Appropriations Committee

has implemented this agreement with a spending bill that passed at the end of December. It was a sweeping piece of bipartisan legislation that contained many provisions and covered a lot of territory. Ultimately, no one got everything that they wanted and it was hard for both sides. But in the end, we reached an agreement that met our obligations, avoided an unnecessary self-inflicted wound, funded some key priorities, and provided certainty that the government would run through the end of the fiscal year.

Looking ahead, we can build on this momentum and pass bipartisan business tax reform so that our economy is one where innovation and ingenuity thrive, where hard work and determination pay off, and where the opportunity to succeed is available to everyone. And I'm confident that as long as we keep our focus on doing what is right for our economy and our nation, we will get this done.

Thank you very much. (Applause)

MR. WESSEL: Thank you, Mr. Secretary, and thank you for coming and thank all of you for coming and thank god for avoiding another Washington half-inch snow blizzard. (Laughter)

I wanted to start by --

SECRETARY LEW: We'll see what the rest of the day has in store.

MR. WESSEL: Yes, but this is the high point of the day. After here, it's all downhill. (Laughter)

You mentioned in discussing the goals for business tax reform that you want to see, as we all do, more long-term growth and broad-based prosperity. But the business tax reform that you're proposing and that Dave Camp talked about in part says let's do away with accelerated depreciation to pay for lower tax rates. And I'm having a hard time understanding how that helps economic growth when economists tell us that

actually encouraging investment, that is accelerated depreciation, is the one thing that the tax code can most do to produce growth.

SECRETARY LEW: You know, David, if you look at our tax code it has lots of incentives to do a lot of things, not all of which are productive and help the economy grow. I think an awful lot of intellectual energy and time in corporate planning goes into figuring out how to navigate through our extraordinarily complicated tax code and that that time were better spent looking at what would be most productive, most efficient, what would increase the bottom line of the business, and that were the driving consideration, it would lead to more efficient decisions, more effective business plans, and that will lead to greater economic growth.

I don't think it's a good thing when our tax code drives investments in a way that is not what contributes the most to a thriving economy. That's not the way to produce the most jobs in our economy. And we've made clear we want to encourage manufacturing, we want to have incentives for research and experimentation. So it is not the case that we think that there should be no provisions that suggest what we think is important. We've made clear, we think manufacturing and innovation is very important. But our current tax code is not leading to the kind of decisions that add up to the most efficient economy and the most productive economy.

And when companies move overseas and move their corporate headquarters overseas, they're taking good jobs overseas. That's not a good thing.

So I think our plan and the kind of approach we've taken will lead to a lot of individual decisions, which when you add them together will lead to more economic growth.

MR. WESSEL: And how does this help reduce in equality, share prosperity more broadly?

SECRETARY LEW: Well, if you create more jobs and more opportunities for good middle class jobs that's ultimately the way to give people more opportunity to get into the middle class, to earn the kind of living that supports a family.

The infrastructure piece that we talk about is easy to see. If we were to put a big, new investment in infrastructure over the next several years, those jobs are good middle class jobs. They do work that we so badly need.

You know, when you talk to CEOs in this country one of the three issues they always raise with you is infrastructure. If we're going to have a competitive economy in the next generation we need to have the roads, the bridges, the ports, the tunnels to move commerce. And creating good middle class jobs now will help create good middle class jobs in the future.

MR. WESSEL: You spoke about business tax reform, by which I assume you mean both corporate and the so-called passthroughs or Subchapter S corporations, businesses. In the past, the Republicans have tried to do business tax reform and combine it with individual taxes. And you've argued that that's a nice idea, but it's not politically going to work. Do you have any reason to believe that the Republican leadership -- Congressman Ryan, Senator Hatch -- are willing to do a business tax reform only?

SECRETARY LEW: So I'm not sure I would agree it's a nice idea. I don't think lowering the top individual rate is the way to grow our economy or create a better future for middle class workers or for the country at large. I think that on individual taxes we have differences that are very clear. I do believe that on business tax reform, and we have always said business not corporate because we have provisions that are aimed at delivering real benefits to small businesses as well as corporations, there is the possibility of a bipartisan consensus.

I've had, over the last few months, quite a few conversations that suggest more openness to this conversation than there was before. I think a key element will be having it be clear how much we all care about having benefit that goes to small businesses as well as large corporations. And in my remarks I tried to give a few examples of things that we think are of great value, and we're open to a discussion in that area.

I don't think that there's any advantage in pretending that there aren't big disagreements on the individual tax side. We had a national debate just two years ago about the top rate. We're not looking at a kind of negotiation to go back to lower the top rate. So the way to deliver benefits for small businesses is going to be through the parts of the tax code that are directed at small businesses, like the expensing provision that I mentioned and a number of others.

MR. WESSEL: So if I'm reading it right, you're saying that you see a political path towards doing business tax reform in cooperation with the Republicans and leaving the touchy issues of the top marginal rate aside and for some other day.

SECRETARY LEW: Look, I think that there is a growing consensus on a lot of the ideas that the President's laid out that I discussed this morning. From a growing consensus to an agreement on legislation is a pretty long way.

MR. WESSEL: So what are the odds? What are the odds that we're going to get business tax reform before the end of the President's term?

SECRETARY LEW: David, I'm an optimist, so I'll always say better than 50-50. (Laughter)

MR. WESSEL: Better than 50-50, okay.

SECRETARY LEW: I think that most people who think about business tax reform always say you can't do it because you're taking on deeply entrenched special

interests that will always win. I don't believe that.

In 1986, we proved that when you get together in a bipartisan basis to do things where you're helping the whole country, you can have a louder voice than the individual voices that want to protect the status quo that does not help the economy. And I'm optimistic that we can reach an agreement here. I really am. I think that there's good will on both sides to pursue the conversation.

You know, it doesn't help to pretend that this is going to be easy. It's always hard. But it's not worth being here doing the jobs we do if you don't try and succeed at doing some of the hard things.

MR. WESSEL: Makes sense. You mentioned dynamic scoring, the business of putting into the price tag on bills the macroeconomic effects. And you suggested some of the problems with it that requires a lot of assumptions and there are a lot of uncertainties, but is there a silver lining here? If Congress were forced to think more about the economic growth implications, not only of spending bills -- not only of tax bills, but of spending bills, like infrastructure, might that move us closer to the goal or do you think it's all just smoke and mirrors?

SECRETARY LEW: Well, I have never said that we shouldn't look at alternate analyses as a way of thinking about what we do, but there's a big difference between what you use for the purpose of scoring and what you do for the purpose of analysis. And it's very dangerous to use scoring methods that may in the end exaggerate what your savings are and understate what your costs are, and end up with a fiscal problem that is just much, much more severe.

So I think that the discussions of dynamic scoring cannot let us slip into a place where we look the other way if there's high risk that some of the decisions we make will leave behind a big fiscal mess. I've had the misfortune of inheriting fiscal messes a

couple of times. I've taken some pride at helping clean up fiscal messes. I think we each have to be careful and not create those kinds of problems.

MR. WESSEL: You spoke approvingly of the Ryan-Murray spending bill that helped us avoid a shutdown, but that bill left in place some caps on domestic and defense appropriations that were set in 2011. Are you comfortable with the level of those caps? Are they wise?

SECRETARY LEW: Look, I have never thought that the caps were set in the right place. I think that we have tremendously important needs in this country that are both on the defense and non-defense side that will lead to a stronger economy and a stronger nation if we have the room to invest sensibly. I think in the context of a conversation about these kinds of issues there will have to be some further discussion about how you pay for providing some additional room under the caps.

I think that there's growing interest on the Republican side, particularly because of the impact that the caps are having on defense spending. And, you know, we've proposed for a number of years now a way that we could go forward in a fiscally responsible way and provide some --

MR. WESSEL: Being paid for meaning that we would spend more money than the caps allowed, but there would be no effect on the deficit?

SECRETARY LEW: If you look at -- I'm not going to get ahead of this year's budget, but if you look at the past, we've made it clear that there are tradeoffs that could make that possible.

MR. WESSEL: When I listen to Republicans talk after the President's speech and basically since the election, the strongest point they've made, I think, is that the public has voted for smaller government and the President continues to act as if the public didn't say anything and that he continues to push for bigger government. How do

you respond to them when they say that?

SECRETARY LEW: I think if you look at what the American people want, the President's policies line up very closely with what the American people both want and need. I don't know anyone who thinks it's a better life to sit for two hours in traffic for a half an hour ride. Infrastructure is not something that has Republican and Democratic lines to it.

It's always hard to pay for it. The question is not should we do it, but how do we pay for it? One of the real advantages of tying it to business tax reform is you're taking a priority that businesses care about -- infrastructure -- a priority that the American people care about -- infrastructure -- and you're using one-time savings which really should be used either to reduce the deficit or to pay for one-time expenses in order to fund it. That's a recipe for getting things done.

MR. WESSEL: Let me turn a bit to the economy. You mentioned that the International Monetary Fund this week revised up their forecast for the United States -- they expect 3.6 percent growth this year -- while revising down their forecasts for pretty much all the rest of the world. Is that realistic? Can we have a really great economy in 2015 and 2016 given all that's going on in China, Japan, Europe, Ukraine, the Middle East?

SECRETARY LEW: David, the United States is recovering in a much more strong way than much of the rest of the world, and we have a much better growth path than much of the rest of the world. I think it's because of the factors that I described. We made sensible policy decisions. We have a resilient people. And we have businesses that get back on their feet after a tough time.

I think that we are in a very different position now than we were even in 2012, when there was a lot of concern that if Europe was a little weak or if Asia was a

little weak it might throw the United States back into recession. Nobody believes that today. I work really hard to make sure we get every tenth of a point positive growth that we can, but the discussion now is do you lose a few tenths of a point, not do you see the United States slip in a dramatic way?

Now, with that said, I do not believe that it's good for the global economy for the United States to be so much stronger while everyone else is so much weaker, but the answer is for the others to get stronger. The answer is for others to adopt policies that will help drive their economies forward. And if you just think about a car with one tire that's fully inflated and four that are either flat or losing air, that's not good. And we have a global economy that needs to have, you know, fully inflated tires everywhere in the world.

The good news is I think there are policies that can be pursued to get there. It's political decision-making, not economic necessity that I think is holding back global growth.

MR. WESSEL: Well, let me push on that. So you're on your way to Europe. You have kind of an interesting agenda: Davos, Ukraine, and Auschwitz. I don't know who does your traveling planning, but. (Laughter) What do you tell the Europeans that they should do to get their economies stronger for their sake and ours? And how much leverage do you really have with them?

SECRETARY LEW: Look, I think we've made our views very clear, I've made my view very clear, that we believe Europe needs to pursue all of the different policy levers that it has at its disposal. It needs to use fiscal policy, it needs to use monetary policy, and it needs to do structural reform. We've made that clear in a global setting with regard to other countries, as well.

I believe the United States has a lot of influence in the world, largely

because of the example we set. And it is very interesting, in the two years that I've been Treasury Secretary, we were just getting to the point where the world stopped blaming the United States for the financial crisis and now we're at a point where everyone marvels at the durability of the U.S. economy, the resilience of the U.S. economy, how we bounced back. It didn't happen by accident. It really didn't. And I think that countries can learn from that and make these decisions.

Obviously, politics around these issues are hard domestically and in regions around the world. I think we have a responsibility to make clear what we believe has helped drive U.S. growth and lead by example and participate in global conversations to drive these issues forward.

MR. WESSEL: But aren't you a little frustrated? I mean, Germany is sticking to its goal of a balanced budget even though it's the one of the major countries that has some room to maneuver. The European Central Bank is inching towards quantitative easing, but may do it in a way that dilutes its effectiveness. The debt overhang in Europe remains strained. Don't you feel like you're beating your head against a wall sometimes?

SECRETARY LEW: I think these are important issues that require our sustained effort to try and drive them in the right direction. (Laughter)

MR. WESSEL: I'll take that as a yes. Let me ask you one final question and then we'll turn to the audience.

The President spoke pretty forcefully last night about climate change. But in this era of bold initiatives, things that we care about that we can do with the Republicans, things that we care about that we know we can't do with the Republicans, but we want to put down markers, you apparently decided not to go to increase the gasoline tax or to propose a carbon tax even though the lower oil prices might make that

a little more politically palatable. Why not?

SECRETARY LEW: You know, David, I think anyone looks at the policy that our administration has pursued cannot mistake our view. We have an enormous commitment to making progress on these climate change issues. We've pursued an agenda with the tools that we have available to work through existing law to make as much progress as we can.

We've worked internationally. The agreement that President Obama and President Xi reached was quite historic and will set the stage for further international progress here. So I don't think there's any mistaking our commitment to moving forward on this. We believe it's the right thing to do for economic reasons, as well as to save the future of our environment, and we're very determined to continue making progress.

MR. WESSEL: But you think someday we'll get a carbon tax or is that just --

SECRETARY LEW: You know, I'm going to leave the discussion of how to deal with it to engaging with Congress. We've made clear we're prepared to engage where Congress is prepared to engage. Because we're seeing Congress' willingness to deal with this issue, not keeping up with the urgency, we took the steps that we took administratively and we remain ready to work together on a bipartisan basis because this is truly one of the issues of our generation where we're going to be measured by whether or not we've taken it seriously.

MR. WESSEL: I think we have time for a few questions. Can I have a mic down here for Ted Gayer for the first question?

MR. GAYER: Thank you, Mr. Secretary, again for being here. I just wanted a quick follow-up question on inversions, which you mentioned a number of times in your speech.

I couldn't quite tell if we're talking about a carrot or a stick approach. And on the carrot approach one can imagine lowering rates, which you alluded to, which would decrease incentive to differ and to invert. You could also imagine eliminating deferrals altogether, which I guess would be a stick approach. Or you could imagine a regulatory approach where you tighten up some of the accounting standards.

So my question is, is this an all-of-the-above strategy? And then the second half, on the last one, is this something you can proceed on, on the regulations side, even if legislation doesn't move forward, in order to make it a little more difficult for companies to invert?

SECRETARY LEW: You know, Ted, we, I think, took quite decisive steps in September to clamp down on the economic value of inversions and the mechanisms by which companies can actually go forward. We made clear at the time that we were continuing to look at other administrative steps, but I've been very clear from the beginning: we cannot, through administrative steps, totally shut down inversions.

We have the problem that we have a tax code that makes them economically attractive and a tax code that makes them legal. So the only way to really fix it is to go back and fix the tax code. So we'll continue to work as hard as we can with the tools that we have because I think the outrage the American public felt last year over this issue was fair.

I hope that the debate we saw in this country over inversions last year will underscore the importance of proceeding with business tax reform. Because if in the end where we end up is with a system that is simpler and more fair and that gives businesses incentives to invest in the United States, it will be good for creating jobs here.

So, you know, I'm not going to say that we're done looking at

administrative things. We certainly will continue. I hope that we make progress on legislation so we don't need to look at half solutions.

MR. WESSEL: There's a woman here next to the gentleman in the white shirt.

MS. KOHRS: I thank you for taking my question, just a follow-on about the --

MR. WESSEL: Tell us who you are, please.

MS. KOHRS: Oh, sorry, Cecile Kohrs with TIG Advisors in New York. Just to follow on the question on inversions. Is there a sense of when we might see the regulations supporting the September 22nd statement coming or when we'll see anything else to follow?

SECRETARY LEW: I think the notice that is out there has been well understood and is very clear, and we're continuing to work on the regulations. But I don't think there's any ambiguity about the policy that was set forth.

MS. KOHRS: Right, but any data on when the regulations to support it --

SECRETARY LEW: They're working through the process. But as I think you know, it's a pretty well established practice to proceed the way we proceeded. And for people who are doing tax planning, lawyers and accountants, they understand what the new rules and the new interpretation is.

MR. WESSEL: Thank you. Doug Elliott here in the front.

MR. ELLIOTT: Doug Elliott with Brookings. One area of business taxation you didn't address today was taxes on the financial sector. It was clear in the run-up to the State of the Union, though the President himself didn't mention it, that there would be substantial additional taxes on at least the larger financial institutions. I was wondering if you could tell us more about what that would be, why it's being done.

I know some in the press have misinterpreted this as being about too big to fail, yet I think many more institutions would be covered than just that. So presumably, there are other reasons you'd be doing this.

SECRETARY LEW: Yes. First, it's not a new idea to have a financial services fee. We've had one for most of this administration in our budget, but the structure of it has changed. You know, it started out as a way to pay for TARP. We're now getting on in time. We're getting out of TARP. And the new structure is really designed at looking forward, not backwards. It's what are the risks in the financial sector going forward?

And we set a limit, firms of 50 billion and above. And --

MR. ELLIOTT: Not just banks, other financial institutions.

SECRETARY LEW: Yes, other kinds of institutions, asset managers, insurance companies, et cetera, and targeted the fee not just on size, but on whether or not they rely heavily on short-term wholesale funding.

I think that there's been enormous discussion amongst the financial world, both U.S. and internationally, about the risks of the mismatch between short-term funding and long-term commitments. And we believe that this is a fee that will actually help to make the system safer and it will take the risk that's associated with short-term wholesale funding and have it be more internalized into firms. And it will also, ultimately, be seen in part of an overall business tax reform plan which, obviously, will have other implications in terms of financial and other industries.

MR. WESSEL: The gentleman next to you.

MR. LAPERRIERE: Hi. Andy Laperriere of Cornerstone Macro.

Both you and David mentioned Congressman Ryan and Senator Hatch. Have you sat down with them in their offices and how would you characterize the

progress that you've made, if any, so far?

SECRETARY LEW: I have remained in close touch with the chairs and the ranking members. Obviously, Congressman Ryan is just new as a chair, but he was chairman of the Budget Committee before that, so I've had ongoing contact with him.

I'm encouraged that there's the broad interest in pursuing a bipartisan discussion on business tax reform. I think that the principles that I laid out are reflective of ideas that I've seen Republicans in both the Finance and Ways and Means Committees show interest in. And I wouldn't be saying I think we can get this done if I didn't think there was interest in engaging in the process.

MR. WESSEL: That young man by the camera there.

MR. TOXEXLEY: Hi. I'm hoping you can talk about the Trans-Pacific Partnership and specifically the economic impact.

MR. WESSEL: Can you just tell us who you are?

MR. TOXEXLEY: Oh, I'm Metchin Toxexley. I'm a student.

SECRETARY LEW: I think as the President said last night in the State of the Union, you know, we stand to gain a great deal by writing the rules for the future in a way that has high standards and will make investment in the U.S. and exports from the U.S. attractive. There's no secret that the growing population in the world is outside of the United States. We want to participate in those growing markets. And the only way to participate fully in those growing markets is to have fair rules of the road that we helped to write.

I think that the idea of the Trans-Pacific Partnership was to start with high standards and to say we want to work with countries that are willing to accept high standards. And five years ago, no one knew whether major countries would want to engage in it. And we now have one of the most significant group of countries in the world

saying we all are prepared to live with high standards. So I think it's important to set high labor standards, to set high environmental standards, to make it so that markets are open and fair. And I think we're making real progress.

What the President said last night is very much the case, that in order to pass trade agreements you need trade promotion authority. And our first challenge is to get Congress to approve a TPA.

MR. WESSEL: And why is it, do you think, that so many liberal Democrats in the House in particular are resistant to that?

SECRETARY LEW: You know, I think this is not new to today or this year. As those of us who've worked on trade agreements for the last 30 years know it's always a challenge to get a bipartisan consensus. And I don't think it's any different now than it is in any of those other periods. We can work through the concerns and get there. So I don't think it should surprise anyone that these issues are tough.

MR. WESSEL: The gentleman right there and then we'll come to the front and I think that'll be it.

MR. STUTTS: I was --

MR. WESSEL: Tell us who you are, please.

MR. STUTTS: I'm Ben Stutts with Strategas Research Partners. And I was wondering when we might expect the President to release more details on his tax reform proposals and how detailed we might expect those to be.

And then, also, regarding the individual proposals that he's laid out for these family tax breaks, would that be required to be part of any business tax reform or would he be open to pursuing the business tax reform without also ensuring the family tax breaks?

SECRETARY LEW: Well, the President's laid out a framework for

business tax reform that I think has been quite clear for several years and actually more detailed than many people realize because they were so quick to dismiss that there could be a serious conversation that they didn't read all the details. So I would encourage everyone to look back at the whitepaper we put out because it's still the foundation of what it is we're proposing. As we do every year, we'll put a green book out with the budget that will have more details on our budget, and we'll be discussing this issue. I tried this morning to add some of the texture to the conversation.

You know, I think that people in Washington get overly caught up with who's put a plan out? Is there a plan out? The way you get this done is by sitting down and working through the detail. I think everybody knows the shape of a business tax reform plan that we want. I think we know the shape of a business tax reform plan that might be the basis for a bipartisan agreement. The challenge now is to go forward with Democrats and Republicans to have these conversations, and I'm looking forward to that process.

MR. WESSEL: The gentleman here in the front.

MR. BANERJEE: Thanks for taking my questions, Mr. Secretary.

MR. WESSEL: Tell us who you are.

MR. BANERJEE: I'm Shantanu Banerjee from Treasury's Office of Economic Policy under Karen. And so I wanted to ask you --

SECRETARY LEW: Does this break your rules?

MR. WESSEL: No, that's great. You're going to be judged on how tough the question is. (Laughter)

MR. BANERJEE: I mean, I'll hear it back there because I'm an intern, so. (Laughter)

But, yes, you mentioned so tax breaks for firms in the U.S. for returning,

lowering the corporate income tax rate or possibly changing it, increasing tax credits for Americans with children, and so I wanted to ask, realistically speaking, what particular issues that you mentioned today do you think Republicans will at least meet you halfway on, be it even tax reform or even going on to minimum wage, student loan interest rates, et cetera?

SECRETARY LEW: You know, I think that if we could sit down and work through these issues one by one there are actually more issues where Republicans and Democrats could reach agreement than most people think. Our system has been so locked in kind of partisanship and gridlock that we don't even have the conversations to find where the areas of commonality are.

I think that it would be a good thing for the country if we could make progress on trade and business tax reform, if we could break the logjam on that. You know, I think there are a lot more issues where if you just look at what the American people want and what we need to do to move the country forward we could reach agreement.

So I'm not going to give you a list of the items, but I do believe that there's a lot that the President said last night that ought to be the basis of good bipartisan conversations.

MR. WESSEL: Well, why should we believe the next two years are going to be any more harmonious than the last two?

SECRETARY LEW: I think if you look at the last two years, we actually got more done than people remember. There clearly were some bad moments in terms of brinksmanship, which I hope we don't go back to, but there also was the Murray-Ryan agreement that provided for a kind of orderly process for two years to continue doing the important work of the federal government without brinksmanship. There was an

agreement on the farm bill. There was an agreement on a water resources bill. I think there are areas where we can continue to make progress.

There's no question but there's a need to rebuild some trust between people who disagree. It didn't use to be the case that if you had different points of view there was nothing that you could find as an area where you could work together. I don't think that's the case now either. That's certainly not what the American people want.

What the American people want is for us to hold to our beliefs, but find the areas where we can make progress, and that's what last night's speech was all about.

MR. WESSEL: Thank you very much. Please remember to stay in your seats till the Secretary leaves. If there's coffee cups at your feet, take them with you. And join me in thanking the Secretary for his time. (Applause)

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