SMALL BUSINESS: THE KEY TO ECONOMIC GROWTH

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

HEARING HELD
APRIL 27, 2017

Small Business Committee Document Number 115–017
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PUBLISHING OFFICE
25–204 WASHINGTON : 2017

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SMALL BUSINESS: THE KEY TO ECONOMIC GROWTH

THURSDAY, APRIL 27, 2017

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH,
TAX, AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Dave Brat [chairman of the Subcommittee] presiding.

Present: Representatives Brat, Knight, Kelly, Evans, and Murphy.

Chairman BRAT. All right. Good morning, and welcome everybody. And I will call this meeting to order. And we are very excited for this panel on economic growth. I think it is very important for our country right now.

No matter where you stand or what side of the aisle you are on, I think everybody in this room hopes to help create and sustain long-term economic growth. Achieving economic growth can improve the health, wealth, well-being of every American amongst every other variable under the sun. I think our panel will probably get to that today. However, the best course to achieve sustained economic growth is frequently debated here in Washington. The United States has been stuck in a slow growth period for a couple decades. While the growth in the United States was about 3.5 percent from 1950 to 2000, the economy grew at an anemic rate of 1.6 percent in 2016, and about 1.5 percent over the last 8 years.

However, when Commerce Secretary Wilbur Ross was asked this week if the U.S. can return to 3 percent growth he responded, "With all the initiatives that we are doing, regulatory reform, trade reform, tax reform, and unleashing energy, there is no reason why we should not be able to at least hit that long-term average, if not beat it."

This morning's distinguished panel will cite a variety of reasons why the country has experienced slow growth, but one overarching theme we will hear is that Washington can do more to help America's businesses with the largest growth potential small businesses. They represent 48 percent of the workers in the private sector and make up an overwhelming amount of all businesses. And yet, today's panel will examine that more can be done to ensure their success.

With next week being National Small Business Week, today's hearing is a timely opportunity to discuss the connection between small businesses and economic growth. This Committee and the Administration's prioritization of regulatory relief is sure to greatly benefit small business in the coming years.

While small business owners painstakingly finished their tax returns last week, simplifying and lowering tax burdens would be a significant boost to both small businesses and economic growth.

Access to capital is another issue that must be addressed to ensure the success of small businesses. While Congress and the Administration are committed to reviewing regulations that inhibit access to capital, the Subcommittee is also concerned that venture capital investment is largely concentrated in only a few metropolitan areas.

As all of these suggestions point out, there is not a simple fix to improve economic growth. There is no silver bullet. However, through examining what creates economic growth and promoting pro-growth policies, the Subcommittee hopes to help the economy return to the historical average, and perhaps beyond.

We look forward to hearing from our witnesses and thank them very much for being with us today. We will certainly benefit from their perspectives on how to improve economic growth through fostering small businesses. And I now yield to the ranking member for his opening statement.

Mr. EVANS. Good morning, and thank you, Mr. Chairman.

Ten years ago, our Nation was hit with the largest economic disaster since 1929. During the fiscal crisis of 2007-2008, we saw housing prices and unemployment skyrocket. By 2009, unemployment had reached 10 percent nationally. Fortunately, today, several years of steady and sustained growth have put our economy on the right track. Unemployment has remained below 5 percent for well over a year. In fact, last November, the employment rate dipped to 4.6 percent, the lowest it has been since 2007.

We have seen considerable job growth. Over the course of the Obama administration, America gained over 11 million new jobs. His presidency saw 75 percent straight month job creation, the largest continuous stretch of job growth in the U.S. since 1939. Finally, median household income surged in 2015, rising by 5 percent for the first time since 2007. These economic markers indicate that our Nation has made great progress, yet we are still feeling the effects of the Great Recession.

Access to capital remains a major challenge for small businesses and business formation at an historic low. GDP, growing at an average of just over 2 percent, and many economists do not believe a significant increase is likely. That is why it is so critical that we examine our current economic situation and the policies that will boost economic growth.

Unfortunately, as the Trump administration approaches its 100-day mark, policies that are likely to reverse these trends are scant. The administration has offered proposals that rely on failed economic theories that will help the wealthy at the expense of the middle class. We have ill-responsibly slashed regulations, proposed huge tax breaks for the wealthy, and proposed major cuts to funding for education, health care, and programs that small businesses rely upon, all while likely raising the deficit.

In order to truly grow our economy, we need to invest in our Nation's infrastructure, our human capital, and our small businesses. Due to chronic underinvestment, America's infrastructure is crumbling. The state of infrastructure has a big impact on the economy's ability to function and grow. Investing in infrastructure creates jobs. Increasing spending by just 1 percent point of GDP would increase to 1.8 million jobs with 1.3 million in the construction industry alone, one of the industries that was worst hit by the financial crisis.

Small businesses have been called the "backbone of the American economy," and as we evaluate tax policies and the effectiveness of regulations, we must ensure that small firms have a seat at the table. By supporting small businesses and entrepreneurs, we spur job creation and economic growth.

Finally, as we develop policies to spur economic growth, we must ensure that all Americans can benefit from it. That means ensuring economic opportunity for all individuals. Barriers to economic opportunity can include a lack of access to quality education, health care, employment, housing, and equal pay.

All of these issues directly impact our economy and small businesses and they work for us. We must examine policies that directly address these barriers to not only create a more equal society, but a stronger one.

I look forward to today's hearing and thank the witnesses for being here. I thank the chairman, and I yield back the balance of the time. Thank you, Mr. Chairman.

Chairman BRAT. Thank you, Congressman. Thank you, Dwight.

If Committee members have an opening statement prepared, I ask them be submitted for the record.

I would like to take a moment to explain the timing lights for you. You will each have 5 minutes to deliver your testimony. If you go over it is no big deal.

The light will start out as green. When you have 1 minute remaining the light will turn. Finally, at the end of your 5 minutes it will turn red. Try to stay somewhere in that time limit, but we do not have a full panel here and so I think we are all going to take advantage of the expertise in front of us today, and you are all on the cameras so do not make any mistakes at all.

With that, I will start off with an introduction.

Start off by introducing someone very special to me, our first witness is Dr. Robert Barro, the Paul M. Walberg Professor of Economics at Harvard University. He is one of the preeminent experts on macroeconomics and the determinants of economic growth and has written extensively on both topics. Over two decades ago, I did my Ph.D. up here at American University on economic growth, and Dr. Barro was the leading light in the Nation on growth. And so I read every paper. I could not read fast enough to keep up with all the papers he was writing at the time. But inspiring and leader at Harvard, obviously, and for the country, and speaks for itself.

Other research interests for Dr. Barro include the impact of rare disasters on asset markets and macroeconomic activity, as well as the interplay between religion and the political economy. He received his Ph.D. from Harvard University, his bachelor's degree from California Institute of Technology. Thank you very much for joining us here this morning, and you are recognized for 5 minutes. And you may begin your testimony. Thank you, Dr. Barro.

STATEMENTS OF ROBERT BARRO, PH.D., PAUL M. WARBURG PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY; ANDREW SHERMAN, PARTNER, SEYFARTH SHAW LLP; STEPHEN MOORE, DISTINGUISHED FELLOW, PROJECT FOR ECONOMIC GROWTH, INSTITUTE FOR ECONOMIC FREEDOM AND OPPORTUNITY, THE HERITAGE FOUNDATION; CHAD STONE, CHIEF ECONOMIST, CENTER ON BUDGET AND POLICY PRIORITIES

STATEMENT OF ROBERT BARRO

Mr. BARRO. Thanks very much for those kind words. I hope I do not disappoint you given your Ph.D. thesis.

I wanted to make some general remarks about economic growth, and I think sustained economic growth is certainly the key to levels of standards of living in the United States and in other countries. And so as some quick examples, in the United States, the average growth of the real GDP per person from 1869 to 2000 was about 2 percent per year, and that was enough over that period of more than a century to increase the level of per capita income by a factor of about 16. And basically explains why today the GDP per person is more than $50,000 in the United States. It is a little less clear whether since 2000 this record of growth has been continued because it appears to be more sluggish than it used to be.

A prominent example of the importance of growth is China, which opened up considerably after the death of Mao in the mid-1970s to market forces and to enterprise. They managed to grow at a remarkable per capita rate of over 6 percent since the early 1980s. This has moved several hundred people out of poverty in China. I think it is probably the all-time greatest experience with respect to improving human welfare.

India has moved since the mid-1980s and not quite the same, but in some analogous ways and has done almost as well in terms of growth since then and has similarly contributed to a vast reduction in world poverty.

Another prominent example is the comparison between South Korea and North Korea. The main difference since the end of the Korean War in those two countries is the openness to markets, to enterprise, to rule of law; also, democracy later on in South Korea. And this experience explains why today the difference in terms of levels of per capita income is a remarkable 15 to 1 between the South and the North. By comparison, at the end of the U.S. Civil War, the difference between the North and the South was a factor of about 4 to 1, and the difference in Germany between West and East Germany was about 3 to 1. So the Korean situation is actually quite unprecedented.

I have looked a lot at the determinants of economic growth for a broad group of countries, so over 100 countries looked at especially since 1960, and tried to assess what things matter for economic growth. So things that seem to matter especially are market orientation and the nature of regulations. Ease of doing business is important, maintenance of rule of law. Human capital is also important. Education and health, I think, are central matters. International openness is an important factor, so economics usually view that free trade is a plus for growth I think is borne out by this kind of data. Saving behavior is important. There is a list of forces that matter. As Congressman Brat said, it is not just one silver bullet, but it is an array of factors and policies that matter for economic progress.

There is also a convergence process that shows up in these cross-country data. One way to look at that is that poor places can grow fast if they get the underlying conditions into the right shape in terms of the nature of institutions, openness to business, and so on, but that is a very difficult thing for poor places to accomplish.

It is also implied that eventually countries will slow down in terms of growth and approach something more like the world average, and I think that is true currently for China. I do not think it is going to continue growing at anything like 6 percent per year per capita, but more like 2 to 3 percent if one looks into the future.

So if I say something more specifically about the U.S. recent performance in terms of economic growth and productivity, a striking fact since the end of the Great Recession in 2009 is the nonrecovery of real GDP. The normal pattern following the end of a big downturn is to have stronger than usual growth for a while. That is the nature of a recovery. So that has not happened. And if you cumulate that up till today from 2010, you are basically missing about 10 to 15 percent in terms of the level of real per capita GDP that you might have expected, so that is a fairly big deal.

And the surprising contrast, as Congressman Evans said, is that the labor market has been pretty strong over this period. So the unemployment rate has gone down a lot particularly over the last few years. Employment growth has been pretty good in terms of job creation. So you have to look at those two things together. GDP growth has been anemic at the same time that the labor market has been pretty good.

If you put those forces together, what it says is that output per worker has been doing nothing. Productivity growth has been zero since 2010. That is why we do not have as much per capita income today as we normally would have expected. And if you think about what policies would be a good idea, you have to think about what policies would spur productivity growth.

So some of the issues that have been brought up I think are relevant if you think about productivity. So I think regulatory reform is something that can be very useful. If you look at the World Bank's measures of ease of doing business, for example, the U.S. has slipped from third or fourth place to eighth place, and improving those kinds of measures would help to spur economic growth, and regulatory reform is certainly relevant there. I think an attractive fiscal package could spur economic growth, and here I would look at things like the proposed cuts in corporate income taxes and individual income tax rates as being positive. I would like to see a 1986 Reagan-style package of tax reform involving further base broadening. Perhaps entitlement reform would be part of this. That would be a more effective fiscal package.

I think infrastructure investment can be important. I think the productivity of infrastructure capital in the U.S. at the margin is pretty high, especially in terms of transportation-type projects. An important issue is how you pay for that. I think there is a good case for that kind of investment on a large scale, but you have to pay for it in a way that does not mess up the overall fiscal balance. Some privatization related to roads, airports, ports, et cetera, can be relevant there.

The biggest concern I have in terms of prospective policies from the administration is in terms of possible protectionism. I would be very much opposed to curtailing international trade. I would, as a related matter, not be in favor of curtailing immigration. Those are the biggest concerns I have.

If I put the overall package together, and if you get reasonable outcomes along the lines of policies that I sketched and you do not have a move toward protectionism, then I think it is quite reasonable to think of generating GDP growth in the range of 3 to 4 percent per year, at least for a few years. I do not think that is anything out of the realm of possibility and that is what I would hope to see coming out of the administration policies.

Chairman BRAT. All right. Thank you very much, Dr. Barro.

Our next witness is Andrew Sherman, partner at Seyfarth Shaw here in Washington, D.C., where he focuses on issues affecting business growth. He has also written several books on aspects of how to grow a business and how all businesses can cultivate innovation to succeed. He received his bachelor's degree from University of Maryland, Baltimore County, and his J.D. from American University. You are now recognized for 5 minutes as well, and if you go a hair over that is all right with us. Thank you.

STATEMENT OF ANDREW SHERMAN

Mr. SHERMAN. Thank you, Chairman Brat. It is truly an honor to be here, not only in front of all of you, but with this very esteemed panel. It has the makings of a great joke, right, when three prominent economists and a lawyer walk into a bar. We can finish that joke after the hearing.

As you mentioned, I have devoted my life to being a legal and strategic advisor to small and emerging companies. I have had the honor of being outside general counsel to a group called The Entrepreneurs Organization that started with 20 members back in 1987, and now has 12,000 members worldwide, and have worked with many, many entrepreneurs over the years. My passion for small business and entrepreneurship must be contagious because my wife and daughter are both now small business owners and entrepreneurs themselves.

This Committee, as you know, is the champion and guardian of small business entrepreneurship, intrapreneurship, innovation, and creativity in this country. You have a fiduciary duty as guardian to make sure that this entrepreneurial ecosystem that both Dr. Barro described, I will be talking about, I am sure others will be talking about, is preserved and protected. You hold much of our country's economic growth in your hands as leaders and as legislators. It is important that we look at that entrepreneurial ecosystem as the crown jewel of our economy. A big component of that entrepreneurial ecosystem is made up in some of the policies that the Federal and State and local governments bring, as well as universities, government labs, a number of resources that we, the taxpayers, all support, and we trust you to do the right things and make the right decisions.

As Dr. Barro mentioned, it is a delicate balance between doing too much versus too little. In my written testimony I lay out the 18 elements of this entrepreneurial ecosystem as I see it, and those range everywhere from human capital issues, which Dr. Barro mentioned, to the importance of strong government R&D partnerships, access to university resources, which I will talk more about. One of my big sticking points, I think as you know in the background, is reliable and fair IP laws, things that we can do to facilitate innovation once it has been created.

One of my big concerns I will get to in a moment is the amount of innovation that we as a country are capable of creating, but then never commercialize. And if you want GDP growth, it is sitting like coins under the sofa cushion. We just all have to get up, lift that cushion up, and distinguish between what is a valuable coin and what may be some old Cheerios.

We need to do better in that role, and I am going to focus the rest of my commentary on three key buckets. In working with entrepreneurs and small business, from a business and strategic planning perspective, most economic growth and their business plans for growth fall into one of three key buckets: the human capital bucket, which has been mentioned; the innovation capital bucket, which I will talk more about; and the financial capital bucket.

I know that it is the work of this Committee to look at access to capital, affordable capital. I think that great progress was made with the passage of the JOBS Act, but as you know, the JOBS Act so far, once the SEC got around to writing the regulations, has been underutilized. We will see how that plays out over time.

One thing that this Committee can focus on is still the access to debt capital. We still have an issue mostly around the nature of small business and entrepreneurs' collateral. If they are not pledging personal assets, most of their assets will be intangible assets, assets that banks are not ready to deal with. I proposed a couple of ideas in the written testimony about things we might be able to do to facilitate.

So the next issue, the issue I want to drill into for a minute is this human capital issue. I recently wrote a book called "The Crisis of Disengagement." I read a Gallup study called "The State of the American Workforce." It came out about 3 or 4 years ago. It was recently updated in December. We have 4 percent of the American workforce; 4 percent that describe themselves as highly engaged. That is a concern, right? We have almost a third of the American workforce that describes themselves as highly disengaged.

Now, the last time I checked, no American worker at a small business or otherwise will be up at night thinking about ways to improve customer service, to improve the product or service of the company if they are highly disengaged in the workplace. They will be up at night thinking about their next job or their upcoming vacation. We need to examine that issue in greater detail.

I called this issue a crisis in my book because I believe in my heart it is a crisis. We cannot have economic growth without an engaged workforce. I mean, that is a huge gap. We have a human capital gap. It is an issue that I am happy to drill into in future hearings, but this part of the human capital gap must be improved.

I will briefly touch on the other two buckets and turn it over to Mr. Moore.

On the intellectual capital gap, we have incredible innovation waste in the country. Millions and millions of dollars that you allocate through university research, through government lab research, never finds its way into the hands of entrepreneurs and small business owners. What can all of us do, whether from a legislative perspective, a policy perspective, a communication perspective, to close that gap? Entrepreneurs and small businesses do not have the resources to create these assets, but they have all of the knowledge and the channels and the energy to bring those assets to the marketplace. So if we can do a better job closing the gap between the two, I think that we can spur economic growth in that fashion. Many commentators from Baruch Lev up at NYU, to Ocean Tomo—to others, have discussed how our economy has shifted.

In 1975, 85 percent of the overall value of the S&P 500 was captured in tangible assets. That has shifted all the way to the other side, and we now have an economy that is driven. I mean, think about the Facebooks, the Googles, all of the great growth stories. They are all made up. Primarily 95, 98 percent driven by intangible assets. So we need to think about the role that those assets play in the economy more effectively, and I think that those two issues alone are capable of really moving the needle on the GDP front.

Thank you. It has been an honor to provide this testimony, and I will turn it over to Mr. Moore.

Chairman BRAT. Thank you very much,

Mr. SHERMAN. We appreciate your testimony and look forward to asking questions.

Our third witness is also a personal friend over the years, highly respected in the field of growth, Stephen Moore, distinguished fellow with the Project for Economic Growth at the Heritage Foundation. He is also a key contributor for the Institute of Economic Freedom and Opportunity at Heritage where he focuses on advancing policies that benefit economic growth in the United States. He received his bachelor's from the University of Illinois, Urbana-Champaign, his master's from George Mason University. Thank you for coming to testify this morning, and Steve, looking forward to your testimony. You may begin. Thank you.

STATEMENT OF STEPHEN MOORE

Mr. MOORE. Thank you, Mr. Chairman. Thank you, Mr. Evans. And I must say that I have agreed with everything I have heard so far. And thank you for letting me talk about my favorite subject, which is growth, growth, growth. And we do not have enough of it. I think that is the central problem with the U.S. today.

I agree with Professor Barro's assessment that there is something that has happened over the last 15 years that has slowed down growth. The latest forecast by the Congressional Budget Office is forecasting with U.S. economy over the next 10, 20, and 30 years we will grow between 1.8 and 1.9 percent. That is completely unacceptable. We cannot solve any of the problems that we want to solve as a Nation, whether it is lowering the debt, lowering the deficit, building the infrastructure that Congressman Evans was talking about, reducing poverty, improving schools, just about anything.

We need faster growth. And at one point, 9 percent growth, we are going to see the United States in terms of our debt in the next 25 years look like Greece and Puerto Rico, and that is very troubling. But if we get faster growth, if we can work together to find ways to just about the growth up to 3 percent, which as Professor Barro said, that would actually be slightly below what we normally had, 3 percent is not shooting for the moon, we can start to see our debt curve slope downward.

If you look at the last, let us see, where is this chart in my testimony? I think it is worth looking at. It is on about the fifth page, the power of expanding the economy, you can see with the red line it is showing what happens to the debt if we stay on the course the Congressional Budget Office is predicting. If we can get to 3 percent growth, look at that, the debt actually does not grow. It does not go to 150 percent; it falls to 50 percent. So growth is everything when it comes to dealing with this budget. Of course, we have to make some tough decisions on the budget, which you have really devoted your time here in Congress, Chairman Brat, but that is important.

Second of all, growth is not just about improving people's living standards. A lot of people say, well, yeah, you know, you can have a lot of growth, but what about income inequality? What about the health? What about the environment that we live in? And if you look at some of these other charts in my testimony, you can see that growth is highly associated with improvements in everything.

So, for example, if you look on the fourth page of my testimony, chart 1, you can see what Professor Barro was talking about, the big increase in living standards, especially in countries like China and India, and you can see the dramatic increase in growth. And look what happened to poverty. So as growth goes up, poverty goes down, which means that a rising tide in most cases really does lift all boats. It makes everybody better off.

But then if you turn to the next page you can see that growth is actually highly associated with these other measures. So life expectancy is highly associated with growth.

Professor Barro talked about the situation in North Korea. Not only is their growth horrendous, but North Korea has one of the lowest life expectancies of any country in the world. Their life expectancy is less than 50, and South Korea, I do not know their exact number. They are probably at about 75. I mean, that is a gigantic difference, 25 years. And that is associated with lower growth, lower nutrition, and so on.

And even environmental protection, by the way, is highly associated with growth. Countries that are prosperous, like the United States, have cleaner air, cleaner water, than nations that do not.

So how do we get there? I would just suggest a couple of things. Number one, this idea that there is secular stagnation and that the U.S. economy can only grow at 2 percent, I think we all need to reject that. Congress needs to reject that idea and say, no, 2 percent is insufficient. How do we get to 3 and 3.5? Well, as Professor

Barro mentioned, there are two ways to do that. You grow the labor force, number one, and number two, you make the labor force more productive.

I want to just in my last minute and a half discuss this issue about growing the labor force. I think there is no reason we cannot see a lot more people working in this country. You all know these figures; the last 15 years or so we have seen a steady decline in the labor force participation rate. By the way, that is not only because people are retiring. It is partially because of that because there are 10,000 baby boomers retiring every day, but that is only part of the story. The more troubling part is that younger people are participating in the labor force at a later age.

You know, when I was at the Wall Street Journal, every week we met incredible captains of industry in finance, sports, medicine. People were great in whatever field it was. And what struck me so much was I would always ask these people, where did you come from? So many of them even grew up on farms. They started working when they were 8, 9, 10 years old, and they developed a work ethic. We have got to get that back.

We spend a trillion dollars a year paying people not to work at the Federal level through welfare programs. Every Federal welfare program, we are a generous, compassionate country, but every single welfare program should have a work component for able-bodied people to get them in the workforce because you cannot escape poverty, Mr. Chairman, if you are not working. It is that simple.

And finally, we need more immigration. I agree with Professor Barro on this. Because of the aging of the baby boomers, we are going to need more legal immigration, not less. And the idea of capping things like the H1B visas at this low level I think is lunatic. I think there is no question that the more skilled and talented and entrepreneurial people we bring into this country actually adds to the number of jobs in this country; it does not subtract from them. So we can do this. We can do it with the right set of policies.

The final thing I will say in the last 10 seconds is that I do think that the tax cuts that Donald Trump introduces tomorrow could have a positive effect on productivity and on labor force. If you reduce the tax on working, you are going to get more work. It is not that complicated. If we can reduce those tax rates on businesses and individuals and increase the reward for working, the after-tax income that people make, you are going to get more people working and that will have a positive impact as well.

Thank you, Mr. Chairman.

Chairman BRAT. Thank you very much, Mr. Moore, for your testimony.

And I will yield now to the ranking member to introduce Dr. Chad Stone.

Mr. EVANS. Thank you again, Mr. Chairman.

I am pleased to introduce Dr. Chad Stone. Since 2007, Dr. Stone has been the chief economist at the Center on Budget and Policy Priorities, a nonpartisan research and policy institution in Washington, D.C. Dr. Stone has also served as an economist of several government organizations, including the Joint Economic Committee, the President's Council of Economic Advisors, the Senate

Budget Committee, the Office of Management and Budget, and the Federal Trade and Communication Commission.

Outside of government, he has worked at the Urban Institute and taught economics at Wayne State and Swarthmore College. Dr. Stone has a B.A. from Swarthmore and a Ph.D. from Yale. Welcome, Dr. Stone.

STATEMENT OF CHAD STONE

Mr. STONE. Thank you. Chairman Brat, Ranking Member Evans, and other members of the Committee, thank you for this opportunity to testify today about the causes, benefits, and current limits on economic growth. These are important topics to understand better if we are to evaluate properly President Trump's bold claim that his policies will supercharge the economy and return us to the higher rates of growth we enjoyed in an earlier era.

I make four broad points in my written testimony. I agree, growth matters, for raising living standards and for fiscal stability.

Second, economic growth over the next decade is likely to be much closer to the 2 percent that CBO is looking for than the 3 percent that the Trump administration is promising. That is looking at the constraints on growth. Policy can nudge that, but policy, I do not think, can make such huge increases in growth.

Third, large tax cuts. They are far from a sure fire way to spur growth, higher taxes do not preclude growth and tax cuts can harm growth if they add to the budget deficit or are paired with cuts to productive public investments.

Finally, small businesses are important pieces of the American economy, but in evaluating sources of growth, it is important to know that it is new businesses, entrepreneurial businesses, rather than small businesses, per se, that are the real thing that matters.

So growth matters for our standard of living and our fiscal health. A growing and increasingly productive economy has the potential to make all our lives better if the fruits of that growth are broadly shared as they were in the generation from 1948 to 1973, when strong productivity growth doubled living standards up and down the income distribution. Strong growth also contributed to a sharp decline in public debt as a share of GDP during that period, even though we ran budget deficits almost every year.

Growth since then has been more uneven and inequality has widened. The economy's capacity to supply goods and services, which is really the ultimate limit on growth—economists call it potential GDP—grew more rapidly in that earlier period than it has on a sustained basis anytime since, and it is likely to slow further going forward.

I refer you to figure 1 in my testimony which shows CBO's estimates of the past and projections for the future of the contributions to potential GDP growth of growth in the potential labor force and growth in productivity, which we all agree are the things that we want to focus on for where growth comes from.

So CBO, as Steve said, projects, and as others have said, projects that the economy will only grow 2 percent over the coming decade, and that is below the 3.2 percent growth in potential that we achieved in the period from 1950 to 2016. And it is slower prospects for growth in potential that CBO focuses on. So President

Trump has claimed that growth could be 3.5 or even 4 percent. Treasury Secretary Mnuchin more recently said 3 percent or higher. This gap between CBO and the administration is historically large in the history of such forecasts.

Economist Edward Lazear, who was president of George W. Bush's Council of Economic Advisors, is sympathetic to the Trump policy goals and cites 3.2 percent growth as a target, nevertheless concluded in his op-ed about this that achieving such a high rate of growth is "unlikely" with respect to the budget.

CBO and OMB calculations suggest that faster economic growth would improve the fiscal outlook. Their evidence suggests that a 1 percentage point increase in annual growth would reduce deficits by roughly $3 trillion over a decade. Of course, that only happens if the growth actually materializes. Basing one's budget forecast on an overly optimistic economic forecast as a way to offset the cost of one's policies will understate the adverse impact, perhaps substantially, of those policies on actual future deficits.

Exaggerated claims for economic growth benefits of large tax cuts have been around since the emergence of supply-side economics in the late 1970s and persist to this day, but there is scant evidence that tax cuts have such large effects, or that tax increases preclude economic growth.

I have just an illustration that growth need not be impeded by tax cuts in figure 2 of my testimony, which looks at growth and job creation following the 1993 Clinton tax increases on high-income folks and the 2001 Bush tax cuts. It is anecdotal evidence; it is not a controlled scientific experiment, but it illustrates that conclusion.

Let me just tick off a list of the other things I discuss in my testimony. First, I discuss Kansas's experience with large tax cuts as a notable recent supply-side failure that has wreaked havoc on the State's budget.

Second, I discuss how tax cuts are likely to hurt growth if they increase deficits or if they cut investments in infrastructure, or antipoverty programs. There is research showing that antipoverty programs actually have a significant positive effect on life outcomes of poor children farther on, going to college, succeeding at work.

Now, today, even the Tax Foundation, which produces the most aggressive dynamic scoring estimates of tax cuts, rejects the claim that Trump tax policy is going to produce enough economic growth to pay for its tax cuts. Now, that is the most extreme of supply-side claims, but even the Tax Foundation says that their model, their aggressive model, does not find that.

Finally, I discuss how a Trump plan to cut rates on so called "pass-through income" encourages tax avoidance, provides almost all of its benefits to very high-income individuals, and does almost nothing for most small businesses, true small businesses, who already pay the lowest rate and would not get any cut from proposals to cut the rate on pass-through income. Figure 3 in my testimony illustrates that.

Finally, with respect to small businesses, I liked Mr. Sherman's testimony and I will add that one of the experts in changing our view about small businesses per se being the main engine of growth to the view that it is new and entrepreneurial businesses that are the engine of growth. And that is John Haltiwanger at the

University of Maryland. What he says is that most entrants fail. Most surviving young businesses do not grow. But a small fraction of surviving young businesses contribute enormously to job growth. A challenge of modern economies is having an environment that allows such dynamic, high-growth businesses to succeed. That is your challenge on your Committee. Thank you.

Chairman BRAT. Thank you very much.

All right. I think I will start off questioning. I was going to start off on regulatory with Dr. Barro, but I think we will go back and forth on tax cuts for a minute. And so Steve, if you could address in a couple minutes, tough to do, but number one, the supply-side term. I am not exactly sure what that means, right? If you gave a tax cut, you can do it on the consumer side to people, right, and that puts money back in people's wallet. But if you are going to enhance productivity, that almost by definition is on the supply side. That is business.

And so the pejorative supply side as a reference to business, I do not understand. But Steven, if you want to take it from there and we are going to try to broadcast some of the proceedings to the public as an educational opportunity. So can you explain just in laymen terms how tax cuts do lead and can pay for themselves, or at least partially pay for themselves in a minute or two?

Mr. MOORE. Look at the Trump plan because that is right smack in front of us right now. We have very, very high business tax rates, virtually the highest in the world.

If you look at the chart on the last page of my testimony, it is instructive. What you can see is that we are living in a globally competitive world today. Do you have the testimony, by the way? It is this chart here with a yellow background.

We are living in a global economy. There is no putting the genie back in that bottle, no matter how big you try to build a wall or a fence around the country. So what has happened over the last 30 years is the rest of the world is, if you see these red pillars falling, these are the reductions in the tax rates of all the countries that we compete with: Germany, Spain, Italy, Ireland, Australia, Canada, and on and on.

So what has happened is we used to have a competitive business tax. If you look back in the '80s and '90s, our corporate rate was actually lower than the rest of the world. The rest of the world has been very aggressive in cutting the rates. They are effectively engaging in Reaganomics. They are cutting their tax rates in large part to steal businesses from the United States. I mean, they are looking at the U.S.

I was just not long ago in Ireland, in Dublin. It is amazing. You know, Ireland does a 12.5 corporate rate. An amazing number of American companies are located there right now.

Well, Chairman Brat, you cut me, I bleed red, white, and blue. I do not want American jobs in Ireland. I want American jobs here in Michigan and Ohio and my home State of Illinois, and so on. This cannot work anymore. We are 15 to 20 percentage points above the average. It is almost unpatriotic to support a system like this where we are putting every American corporation, whether it is Google or Microsoft or Boeing and so on, at, you know, I call this like a Head Start program for every country that we compete with. And it is costing us jobs.

So do I believe that if we bring this rate down from way up here to maybe at or below the international average, that is going to bring jobs and growth back to the United States? Hell, yes, I do. I do not think there is any question about it you are going to see more jobs created. Now, whether or not that is going to pay for itself or not, I do not know. Maybe it could, maybe it could not. Probably not. My only point is that if you can bump up growth by even 0.2, 0.3 percentage points, do it. Do it. I do not even care what it costs. Do it because the long-term benefits and living standards—by the way, we measure these things in 10 years.

The reason my chart is looking at the 30-year impact of these things, is that, you know, there is an old saying that the most powerful force in the universe is compound interest. If you get the compounded effect of even 0.5 percent growth over not 10 years but 20, 30, 40 years, you are talking about major, major increases, not just in growth, but in revenues to the government. And I would say that is a good deal to have.

Chairman BRAT. Dr. Barro, you emphasized the regulatory burden and how we can enhance productivity by dealing with regulations. If you can just go into a little more detail on what you have in mind. Americans, if you could knock door to door like politicians do, if you ask the average family do you want more or less regulation, they will say more, surprising. And so, but at the same time, we have $2.5 trillion of regulatory burden. And so if you are explaining to the average American, how do you differentiate between regulation that is good for the consumer versus that which inhibits economic growth?

Mr. BARRO. If I could respond briefly first to what Steve just said. So I agree what he said on the corporate tax rate. So we have been trying to estimate that in detail for a broad group of countries where we have been trying to measure corporate income tax rates. So preliminary finding there is if you cut the corporate tax rate by 10 percentage points, the proposal now in the U.S. is for even more than that, that that boosts the rate of economic growth on a sustained basis by about 0.3 percent per year. So that is a substantial contribution to growth if that estimate is right in terms of the proposals that are being floated with regard to U.S. corporate taxation.

I have spent more time myself looking at the individual income tax in the U.S. and how it impacts the macro economy. So I found that reducing the average marginal income tax rate in the U.S. system, if you do that by 2 percentage points, the growth effect over a 2-year period is about 0.5 percent per year. It is fairly substantial.

In terms of U.S. history that matters there, the biggest cuts by far are the Reagan cuts in two phases in the 1980s accumulating to 8 percentage point cuts. So that is very dramatic. In contrast, the Clinton episode that was mentioned before was actually an increase by 1 percentage point. It was basically trivial. It was a tax increase, but very small. And I certainly agree the economy grew very well in the 1990s despite that. But it does not really contradict the evidence about tax effects.

The other tax change that was particularly important in the sample is in the Kennedy-Johnson tax cuts of the mid-1960s, which is also fairly substantial and seemed to promote economic growth.

So what you asked about regulations, we have been particularly trying to measure that better using the World Bank indicators about ease of doing business, which has 10 different components, such as cost of starting a business, cost of ending a business, in particular, what do you have to do to go bankrupt, basically. Cost of getting electricity, cost of getting credit, it is a very impressive research effort that the World Bank has been carrying out in this manner since 2004. And it does turn out to be true in this context of this cross-country economic growth experience that better regulation measured in that way has a noticeable effect. So that is an impact that you think about the likely change you could do today in the U.S. that might spur growth by about 0.3 percent per year. That is sort of part of the administration package that one might think about.

So basically, I put together a number of those components. That is what gives the prediction that growth could be higher, in the 3 to 4 percent range over some interval. Infrastructure investment I think could contribute there, but I do not really have good estimates as to exactly by how much, but I think that that could also be positive.

Chairman BRAT. All right. Thank you very much, Dr. Barro. My time has expired.

I would now like to yield to the ranking member, the very patient and kind ranking member, Mr. Evans, for at least 5 minutes or as long as you would like to go. Thank you.

Mr. EVANS. No problem. Thank you, Mr. Chair.

I really want to follow up on the chairman's question and give Dr. Stone and Mr. Sherman an opportunity from your perspective because you were showing a lot of body language, Dr. Stone, when Mr. Moore was commenting. So you get your chance to give your comment there, Mr. Sherman.

Mr. SHERMAN. Well, first of all, Chairman Brat, when I say "supply-side policies," I am talking about anything that increases potential GDP as opposed to short-term economic demand stimulus. And I think that we are very close to full employment now and supply side policies can, if properly well-constructed, supply side policies can boost economic growth to a certain degree, that includes all the things we have talked about. It is just the estimates that Steve likes about how large those estimates are really, that is my complaint. Not that you cannot nudge it a couple of tenths.

Now, Professor Barro and I could have a conversation about whether all those things and adding them all up based on cross-country comparisons is where the United States is going right now, but we all agree on what the sources of growth are. Our question is, what is the magnitude of the supply side? And if you have tax cuts that contribute to the deficit, make the deficit worse, then you are creating a drag from the deficits and that is harmful to growth. Notwithstanding Professor Barro's views, very interesting insights onto long-term savings behavior.

Mr. EVANS. Mr. Sherman?

Mr. SHERMAN. Mr. Evans, thank you for giving the lawyer the last word on this. It is always much appreciated.

Rather than debate, I want to augment two important points. Number one, look, I think everyone in this room would like a tax cut of some sort. Who does not want a few more dollars in their pocket? But let us not talk about tax cuts. Let us also talk about tax incentives.

For 100 years, we have used the tax code to foster and reward behaviors that we want businesses or individuals to make, and I think that as important as the tax cuts are, and I am all in favor of them, I also would like to see a package of tax incentives. The issue is not unemployment anymore, but it is underemployment. We still have a crisis of underemployment in this country. People have jobs, but they are not the jobs that they are capable of doing.

I would love to see a package of tax incentives that would close the gap in the underemployment crisis, reward training and education, reward mentoring and coaching. Reward giving people the kinds of skills within companies that they can be doing what they were educated to do, and I think you will see the ripple effect of that being economic growth. So that would be kind of point one.

I think the other thing is to really, you know, address the issue of how we are going to allocate these resources. Will people, if we give them the tax cuts, you know, put the money into places that will truly stimulate economic growth, and can there be additional rewards or policies that will do that? There is a finite number of dollars in the country and it is about allocating those dollars in the right places to do the right things that will foster economic growth, whether that is in the area of fostering innovation and rewarding innovation or whether it is on the human capital side in closing this underemployment gap that I think exists in this country.

Mr. EVANS. Dr. Barro, you stated poor places can grow fast if the right underlining factors are in place. What are some of those underlining factors?

Mr. BARRO. So those are some of the variables that I mentioned before. The underlining institutional framework, I think is quite important. I think about maintenance of rule of law and market orientation, the nature of the regulatory system that particularly allows businesses to operate effectively. I think policies related to human capital are important, and I mentioned education and health as being important aspects of that. International openness is an issue.

So if you look at a typical poor country, which today the biggest concentration is actually sub-Saharan Africa. It would have been different if you looked earlier you would have found more Asian countries, and you asked, well, why can they not grow rapidly and converge to the richer places?

So I think it is systematically the case that countries that are impoverished are unable to maintain the kinds of institutions human capital policies, other policies that are conducive to economic growth. That is why if you look across a broad group of countries and you ask do the poor grow faster than the rich, the answer was no. But if you look in a conditional sense and you ask if you are a poor place and you get things reasonably in place, like China did starting in the mid-1970s, can you grow fast, and the answer is yes. So it is sort of good and bad news in that respect.

Mr. EVANS. Mr. Moore, during your appearance on CNN Tuesday, you said that the U.S. has the dumbest corporate tax system. What would you suggest to the Trump administration to fix the system? And what is your take on the decision by the current administration to abandon the TPP and the impending decision to do away with the North American Free Trade Agreement? I do not know if the language would be that they said do away with it or renegotiate it. So you now have that chance, you are the Treasury Secretary or you are the senior advisor, which you did say the dumbest corporate tax system. Did you say that?

Mr. MOORE. It is pretty dumb. You could not come up with anything much dumber than what we have.

Mr. EVANS. You did say that. I just want to make sure we got your quote right.

Mr. MOORE. I would bring the rate down. I would get rid of a lot of the exemptions. And one of the things that is really interesting about our corporate tax is that you actually do have a lot of companies that are paying this 40 percent rate, but you have others that are paying almost nothing. The wind industry pays negative income tax. We pay them to produce. So the inequities of the system are also not very efficient for the economy.

So I would try to lower the rate. I would try to get rid of the loopholes in the system. You know, just as the individual system has a lot of loopholes and special interest carve outs, so does the corporate system.

And by the way, I just want to make this point very clear. I am not saying that taxes are everything, by any means. I mean, you know, we have heard testimony today about 100 factors that affect growth and they are all right. I am just saying taxes are one of the factors, and I think we could have a much more efficient corporate tax.

On trade, I am not an expert on trade, but I would simply say this, that I believe in international trade. I agree with what Professor Barro said. There is good news today that Donald Trump announced that we are not going to withdraw from NAFTA, which I think is a smart decision.

On TPP, I have to say I am going to pass on that just because I do not know enough about it. I am for trade with Asia for sure. I just do not know enough about the specifics of that trade agreement to know if there are things on that agreement that were not in America's interest. But on balance, we should absolutely have free and open trade with Asia.

Mr. EVANS. Thank you, Mr. Chairman.

Chairman BRAT. With that, I would like to recognize the gentleman from Mississippi, the very patient Mr. Trent Kelly, my good friend, for 5 minutes at least. Thank you, Trent.

Mr. KELLY. All right, guys. I am a military guy, so let us finish up in 5 minutes and leave some time back to the chairman.

I think one of the greatest things, whether it is tax cuts or we are talking about economic policy or whether we are talking about the stock market is consumer confidence or the confidence of the American people. And I do not think you can measure that. But I can tell you just last week I was meeting with a business from another country that is talking about moving another manufacturer to Mississippi because they like what the President says about the corporate tax rate. Well, to me, I do not know how much money we will get out of the corporate tax rate, but all those individual income tax rates that we have.

The other thing that really concerns me is how we talk about the employment rate in this Nation. We are not almost at full employment. We have people who have given up on getting good jobs. We have people who are overqualified for jobs because of college educations when they should be trained in something that has earning power as opposed to a lot of fun at college. And so I think our workforce is very, very important.

But I disagree that we are at the lowest unemployment rate that we have ever been. We may be by that number and that standard, but I know in Mississippi, when someone gets on government assistance of some sort, 88 percent never get off. And most of those people are not people who cannot do jobs. So I think we have got to get folks to working and everybody have a great opportunity to work.

What is the best way to make sure that we are getting people trained? I think the workforce skilled workers who can make a great wage as opposed to thinking going and getting a liberal arts degree from wherever is going to make them employable. How do we do that as a Nation to make a workforce that is second to none? And, I guess, yes, Mr. Sherman?

Mr. SHERMAN. Corporate treasuries in this country have reached record levels of cash. I mean, multiple articles have been written. The latest trend in CFOs after deploying some cash towards M&A and some other initiatives, not enough towards innovation in my opinion, are now stockpiling again. We talked about tying perhaps a tax incentive of some sort. I would love to see, you know, most large companies have all kinds of private universities that exist within their companies, private education and training initiatives.

I agree with everything you have said. You know, we have a workforce that is hungry for better jobs, to earn more. Those will easily have a ripple effect on GDP by any of our panel of standards. You know, is there something we can do to either lightly or not so lightly encourage the deployment of that cash and the deployment of those resources to get a better trained workforce.

I agree with Mr. Moore, our workforce is not competitive globally. Closing our borders is not going to help that at all. It is going to hurt it. And there has got to be some things that we can do, either create tax or nontax incentives to reward companies for deploying just a sliver of those cash stockpiles and those intangible resources they have to put the people of Mississippi and the other 49 States as well to work.

So it is all there. All of the pieces that we need for 4, 5, 6 percent GDP growth, if I could be that bold, are sitting like coins under the sofa cushion. I ask this Committee, and I ask the leaders of our country to lift up those sofa cushions and start picking at those quarters and half dollars because they are all there. We have the resources to be competitive.

Mr. KELLY. Okay. And very quickly, Mr. Moore, I want to ask you this. What can we tax-wise or capital access-wise do for small businesses that help us to create that workforce that sustains those small businesses? I mean, it could be regulations. It could be some type of tax benefits. But how do we incentive our businesses, our small businesses, specifically, to get a workforce that works for them?

Mr. MOORE. Well, I was struck by the last comment you made in your testimony, that quote from the professor about the different types of companies that are leading to growth, and it is these innovative companies that just take off. You know, trying to find the next Google, trying to find the next Microsoft, and so on. That is hard to do, you never know, and it is true that two out of three companies fail small businesses. So what you need to do is try to find the capital for these companies so that they do not—there are too many examples of companies that actually have a great idea and they run out of money. And before they can launch the thing and really get it to the next level, they run out of money and they go out of business. That happens with drug firms. So finding ways that we can get capital into companies, investment capital, I think would be crucial.

I will make one other quick point. I agree with you on this issue of the labor force, that we can have a lot more people in the labor force. I just did the statistics about a month ago. Looking at the age-adjusted change in the labor force, because it is true, one of the reasons the labor force participation rate has fallen is because so many more people are over the age of 65.

But if you just look at people in a prime 18 to 65 year, so take out the people who are retiring, if we had the same labor force participation rate today that we did, say, in 2000, there would be 7 million more Americans in the workforce.

So I do not buy this idea that we are falling. I hear that all the time. I am like, what are you talking about? We are not near full employment. It is just the unemployment rate number has become really kind of a meaningless—we should really probably report the U6 number because the headline unemployment rate to me has become highly misleading.

Mr. KELLY. And Mr. Chairman, if you will indulge me. And I think the key is most of those people who are not—they are not in the unemployment rate, but they want to work. They want to do a job and they want to be productive for this Nation. Unfortunately, we have got to figure out how to give them businesses where they can work and they are back in the workforce. Thank you.

Mr. MOORE. Can I just suggest one other quick thing because you mentioned this? What could we do to get people better ready for the labor force? I agree with you. The idea of spending $200,000 to go to a 4-year university in a lot of cases in my opinion has become a waste of time. Why not allow people apprenticeships?

You know, when I talk to employers, it is interesting, a lot of them say the biggest problem I have is finding the workers that have the skills we need. I mean, 90 percent of them say that is their biggest problem even when we have tens of millions of people outside the workforce. Why not have a program where you have apprenticeships for somebody who wants to become a carpenter, somebody who wants to become a mechanic, or something like that? And if they get that apprenticeship they have the equivalent of a college degree. Because you know what? That apprenticeship might be better for them than getting a degree in sociology.

Mr. KELLY. I yield back, Mr. Chair.

Chairman BRAT. Thank you all. I think we are verging in at the end. This is a very good conversation and for me it is always kind of interesting because I taught college for 20 years and we all say human capital and everyone talks about policy and politics up here in D.C. But maybe just in closing, if each of you could just give a minute, I am interested in kind of the intersection between policy and culture. And so we all know in K-12 education right now, the teachers are being asked to do the impossible. They have to teach the subjects. They have to teach to the test. They have to do discipline. They have to do gym class. They have to do everything. It is not happening, right?

So I think there is pretty broad agreement on this. Labor force, you know, the unemployment rate, and that all gets into politics as to who is doing good and who is not. And I think we are kind of getting by that.

But there is a cultural issue, and Dr. Barro talked about convergence. Right after you reach high incomes, some of it is just cultural at the high end. You say, hey, I do not need to work as many hours, right? I am going to take vacation. I am going to take a little break from the workforce. But for the lower income folks that is not an option, right? And so we always get into the politics of the haves versus the have nots, and so if the panel, if you want to just comment.

So we wanted to get the right tax policy, but this stuff has to pass bipartisan. So what is a compromise? How do you think about a compromise across the aisle where we get it right for the poor in the inner cities, in the K-12 that is broken? And at the same time, I mean, I do think tax cuts, especially on the corporate side, we have got to get the economy rolling, just the psychological energy there.

But any comments, and let us just start, Dr. Stone, if you just want to kind of close and give us any ideas you have on kind of bipartisan, what can we do to get some agreement going?

Mr. STONE. It is a tough environment for bipartisanship, as you well know.

So first, I would like to respond to the notion—I agree that the Great Recession produced a whole lot of people who were out of the labor force, and that has come way down. U6 is pretty far down. Part-time jobs is a bigger problem than people outside the labor force—too many people still have part-time jobs when they want full-time jobs.

But this argument that so many people on assistance are not working, that is just not what the evidence shows. Large numbers of people on SNAP, on TANF, in fact, work. The lower income population is moving in and out of the labor force. Many times when they are receiving assistance they are still working. The idea that we need work requirements because people are not working is, I think, misplaced.

I think we would do better to look at the evidence on how much people actually are working, and we need a strong economy. If you are going to have work requirements, you need a strong economy where people can actually find jobs. And part of that is increasing the overall growth rate, but part of it is making sure that money is in the places where communities need it.

Chairman BRAT. And so in your view, the kids on SNAP, do you think they have expectations of achieving greatness in their life? I mean, it is always interesting, we talk about vo-tech and technical education, all these kinds of things after college. We are paying $14,000 per year per kid for 13 years, right? I taught economics. Kids do not know what a price is from a cost from a profit after they graduate from high school, and half will not go to college. And so that is what I am getting at. I mean, where do we give this psychological boost that every kids needs to have regardless? Because I do not see it there.

I mean, I taught kids at the higher end. And even they, right, I mean, what are you going to do after you graduate, Johnny? I am going to go ski in Colorado for half a year or something. I am like, okay. They are not pumped up to get to work.

Mr. STONE. I mean, you do not want to hear about more resources, but resources matter, especially in disadvantaged communities in the school system. But also, I will echo what Steve said about apprenticeships or community colleges. That is a place where people who come lately to the idea about success can get education. So if we have useful support for those, encouragement, that is something.

Chairman BRAT. And that is coalescing up here in the Committees. There is broad agreement we have got to go in that.

If you want to close, Mr. Sherman, with a minute or so.

Mr. SHERMAN. Yeah, I apologize. I do need to run. But I think that we are getting to the heart of what could be a bipartisan solution and that is around this issue of training education, whether it is apprenticeships, internships, more corporate participation at all levels of education, more engagement in the classroom. This crisis of this engagement is affecting teachers and students and drawing a bigger gap between ability to learn. Relooking at curriculum, you know, we are still teaching big clumps of information that may not be very useful.

You know, I heard a statistic the other day that the average middle school student, 50 percent of the jobs that they will have when they are in their twenties or thirties do not even exist today. How do we look forward in time and adjust our teaching curriculums around the jobs that will be available and impacted by artificial intelligence, robotics, automation?

I am afraid that we are spending all this money on education, we are not getting the results that we want. Teachers and students are disengaged and we are not teaching the skills that they are going to really need to be competitive and that we are going to need to be competitive in a global workforce.

Chairman BRAT. Thank you very much. I invited the Education members. The members are just slammed right now with all the issues flying around here, but I knew this panel was going to coalesce around those issues and they have an interest, so we are going to start trying to work across Committees on some of this.

Steve, closing remarks?

Mr. MOORE. There is virtue and work. You know, work, work, work. You mentioned the word "culture." I mean, there is a culture now that somehow working with your hands is a bad thing. It is amazing. If you are a mechanic, a pipefitter, a welder, you know, you can make $60,000, $70,000 a year, maybe you start your own business, you can make $100,000 a year. So this idea that everyone has to go to college I think is silly. And I think it is actually even counterproductive.

I am friends with a guy named Bob Funk. He is the single, biggest employer in the United States. He runs a temporary employment agency. He puts 800,000 people a year in jobs. And he always tells me, Steve, I can find a job for anybody in 72 hours as long as they do not have a degree in sociology, history, or political science. You know, it is kind of an interesting dynamic.

And in terms of a compromise or something we could do, look, the point of my testimony is we cannot stay on the track we are on. We have got to do something differently.

And you talked, Congressman Evans, about the infrastructure. We have been talking on our side about tax cuts. I mean, why not a deal where we have a big infrastructure program. Let us make sure that money is spent wisely, and then compare that with some tax reductions that could help spur growth. I cannot remember the last time we had a bipartisan bill in Congress. I would love to see that. I would love to see you two work together to come up with something. I mean, truly, it would be a real breakthrough.

Chairman BRAT. Great. Dr. Barro?

Mr. BARRO. Just one comment on the standard unemployment rate. It is actually surprising how good that indicator is for gauging the tightness of the labor market, sort of the nature of the business cycle situation, whether the market is sort of amenable to kind of standard aggregate demand management. And the standard unemployment rate being close to 4.5 percent is, I think, indicative that in that sense we are close to full employment and do not want to have that kind of demand stimulus.

At the same time, I agree that labor force participation is surprisingly down, particularly in certain parts of the population, so I would emphasize that along with productivity changes in terms of what you can do to spur growth. So I also agree with that commentary.

I certainly think education is the most important factor in terms of underlying productivity and throughout that influencing economic growth. That does not mean that I want a bigger role for the Federal Government in terms of promoting education. I really think typically it is better for public schooling to be at the local level, local and State level, and I would like to see a bigger private role in terms of K-12 education.

So I certainly think that education is very important, but that is not the same as saying I want the Federal Government to do more in that area. That is a conflict between those two conclusions.

Chairman BRAT. Dwight, any closing?

Mr. EVANS. I want to thank you, all three of you, four of you, Mr. Sherman left there, really for this conversation and dialogue. I think it has been, I know for me at least, personally, very helpful. And I thank the chairman for allowing the flexibility. I did not think that happened here. I come out of a legislature where we did not have this like 5 minutes. If you were getting on a roll, you got on the roll. And if the chairman was raising something, you raised a little question, I think that is the only way we are going to get some substantive discussion. So I thank you, Mr. Chairman.

Chairman BRAT. Well, I think we will close on that nice set of remarks right there. You can hear the tone. There is a lot of chatter up here that we do not get along across the aisle and it is just baloney. We all work out in the gym in the mornings and like each other, so I feel some good stuff is coming.

This is the best panel I have ever seen in Congress, just to congratulate you all. I listened to every word, which is very rare. And so this was tremendous. You all did a tremendous job preparing and shared your personalities along with it. And we had differences, but in a good spirit.

So thank you all very much for sharing and that is it. Thank you.

[Whereupon, at 11:20 a.m., the Subcommittee was adjourned.]

APPENDIX

Testimony of Andrew J. Sherman

Partner at Seyfarth Shaw

Before the U.S. House Committee on Small Business
Subcommittee on Economic Growth, Tax and Capital Access

Small Business: The Key to Economic Growth

April 27, 2017
10:00 a.m.

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Chairmen Chabot and Brat, Ranking Member Velázquez, and to all of you hard-working members of this Committee, first I'd like to say it is truly an honor to speak before you today on the economy and the impact of small business and entrepreneurship.

My name is Andrew J. Sherman and I am a Partner at Seyfarth Shaw. My practice focuses on issues affecting business growth for companies at all stages. Over the past 32 years, I have counseled thousands of U.S. and international clients from early stage firms to multibillion dollar conglomerates.

This Committee is the guardian and fiduciary of small business and entrepreneurship in our society and the gatekeeper of economic growth. I commend you for your efforts in supporting the Small Business Association ("SBA"), the Small Business Development Center ("SBDC") network, and (as I will discuss later in my testimony), the Defense of Trade Secrets Act ("DTSA"), and the JOBS Act, which have allowed greater access to crowd funding channels. I have seen first-hand the positive impact of these efforts throughout my career, and especially having served as outside general counsel to the Entrepreneurs' Organization since 1987, which now comprises more than 12,000 members throughout 160 chapters and whose members employ roughly 2.8 million workers worldwide.

Background

Over the course of my professional career, I have written nearly 30 books on entrepreneurship, the legal and strategic aspects of business growth, franchising, capital formation, the leveraging of intellectual property, mergers and acquisitions, and my latest book, which is on the crisis of disengagement and its impact on the workforce and innovation. I have also served as an Adjunct Professor in the MBA program at the University of Maryland for the past 28 years and at Georgetown University Law School for the past 10 years.

In addition, I was the founder of the Small and Emerging Contractors Advisory Forum ("SECAF"), an organization of small and emerging government contractors in the Washington D.C. region, with over 400 members committed to empowerment and advocacy for the contracting industry. For the past 10 years, I have served as a keynote and workshop speaker at the annual meeting of the SBDC and currently serve on the SBDC Foundation Board of

Directors. In 2001, Fortune Magazine included me in their list of the Top Ten Minds in Small Business and Entrepreneurship. In the 1970's, I dropped out of college to become an entrepreneur and while I have since devoted my career to a life serving and supporting entrepreneurship, both my wife Judy and daughter Jennifer are entrepreneurs and small business owners.

Current Data

Turning to present day trends, 2017 has seen a widespread but tempered increase in confidence among small business owners regarding the economy and overall trends in business investment. Business owner optimism has increased in part due to promises of tax reform, regulatory reform, and the strength of the capital markets. We are all aware that small and emerging businesses are the backbone of our country and a significant engine for the creation of new jobs. According to Small Business Trends, family owned businesses account for 78% of new jobs created in America and a significant portion of our overall GDP. Moreover, an increasing number of millennials are poised to take on management positions and bring a fresh outlook to the workplace. Many small businesses are forecasting significant increases in revenue for 2017 and 2018. In just six months, from July 2016 to January 2017, the concern of economic uncertainty for small businesses declined from 49% to 44%. While these statistics are all good signs for the economy, 70% of small businesses with revenue under $1 million are still reporting that access to affordable financing is their biggest hurdle to growth.

In my experience as a legal and strategic advisor, there are several factors that support the entrepreneurial eco-system in the United States, as shown in the chart below.

Elements of the Ecosystem Needed for Small Business and Entrepreneurship to Flourish

Overall Societal/Governmental Structure	Accessible and Stable Capital Markets	Enforceable Rule of Law/Court System
Reliable and Fair IP Law to Foster Innovation and Creativity	Culture that Supports Economic Advancement	Business Structures that Limit Personal Liability

Fair and Effective Governance	Human Capital, Culture, and Fair and Flexible L&E Laws	Our Ability to Redefine Ourselves and Engage in Serial Entrepreneurship
Overall Educational Training Systems	Bankruptcy Laws	Access to Global Markets and Trade/Ability to Compete Globally
Access to Mentors and Advisors, Coaches and Resources/Networks	Government/Private R&D Partnerships	University/Private R&D Partnerships
Exit Strategies (M&A, IPO's, ESOP's, etc.)	Estate Planning and Wealth Transfer Laws	Antitrust Laws

Raising Capital

Capital is the lifeblood of a growing business. The only way to take any business to the next level is to gather the funds needed to fuel growth. Small businesses find that this is the most difficult hurdle to overcome. Stringent regulatory requirements have made it more difficult for banking institutions to offer loans to small business. Moreover, while cycles of the economic downturn put a dent in everyone's pocketbook, for smaller and entrepreneurial companies it robbed them of the critical fuel they needed to keep the engines of the economy moving forward. Main Street often recovers much slower than Wall Street. Payrolls are slashed, creativity is halted, inventories are reduced, capital investment decisions are delayed, and workforce motivation is virtually nonexistent. If entrepreneurial leaders refrain from making new hiring, growth, or capital investment decisions because they are concerned with what new crisis, burdensome regulation, budget deficit, tax hike, or economic downturn may await them, then we face a very slow journey to a complete and widespread economic recovery and our job creating engine will stall.

Reducing Regulation

Streamlining agencies' approval processes at the state and federal level, while still maintaining comprehensive business guidelines, will help businesses open their doors faster and with lower ongoing compliance costs. The current trend to better define the true cost of regulation and its impact on smaller companies, as well as pressure on agencies to publish clearer regulations so that small businesses can understand guidelines, rules and regulations without having to involve lawyers, accountants and other business counselors must continue to be the focus of this Committee.

Narrowing the Innovation and Productivity Gap

We have reached a point where, for both big companies and small ones, over 85% of the assets driving shareholder value and economic growth are intangible, taking the form of innovation, intellectual property, and intrapreneurship (Ocean Tomo, Baruch Lev). These assets include brands, systems, processes, channels, best practices, social media, customer recognition and loyalty, know how, relationships, and related strategic intangible assets. Yet, the latest State of the American Workforce study published in December of 2016 observes that less than 5% of employees surveyed describe themselves as "highly engaged." These are the most creative, innovative, and productive employees in our workforce and surely overall. If we can't engage more workers in the short-term, and sustain them in the long-term, then entrepreneurship as a driver of economic growth and our ability to compete in the global marketplace are severely in jeopardy.

In spite of the potential value of corporate innovation contributing to improved organizational performance, many small as well as established companies overlook the critical importance of engaging their workforce, and thus fail to encourage entrepreneurial behavior or implement effective rewards and incentives. Executives tend to be more concerned about the images of chaos that innovation can portray. In addition, there are often structural impediments in place, most of these being the product of bureaucratic routines and red tape policies that have outlived their usefulness, as well as politics, cronyism, and silo's that stand in the way of meaningful collaboration. Effective managerial efforts are essential to developing an engaged culture that is capable of cultivating employees' interest in and commitment to effective entrepreneurial behavior and the innovation that can result from it.

There are a multitude of studies that emphasize the connection between truly engaged workers and better customer service, higher levels of creativity and productivity, higher sales margins, higher quality products, increased attention to safety, and lower turnover rates. However, what businesses have also recognized, and research has supported, is that innovation within a company is one of the primary drivers of company success, determined through growth. The more interesting element of this equation is where that innovation comes from: engaged employees. A Gallup Management Journal study found that employees who were "engaged" indicated they "strongly agreed with the statement that their current job 'brings out [their most creative ideas.'" The reverse was true for those who indicated they were actively disengaged—in other words, the disengaged individuals in the survey were the least likely to find that their current job incited creativity.

For decades, workers at companies of all sizes and in all industries were expected to know their jobs, do their work, keep their heads down, and only "bother" management with questions to avert a crisis. If a problem arises, know how and when to solve it, and don't interfere with the supervisor's valuable time. That mantra needs to shift if we are going to improve engagement in a way to drive more innovation and shareholder value. Employees at all levels need to feel liberated to ask the "Whys?" and the "What ifs?" They need to be able to ask (without retribution or punishment) "Why am I doing my job the way I am doing it?" "Is there a better way?" "What would it take to change and why?" People are likely to be more engaged when they are empowered to think for themselves and permitted to question the "status quo"—within reason—without the fear of retribution. Empowering workers in this way not only permits the workforce to begin organizing its thinking around the unknowns instead of the knowns, which will inspire greater creativity, innovation, and productivity, but it also demonstrates humility by the leadership team as they acknowledge that they do not have all of the answers and become more accepting of innovation at all levels. Fostering curiosity and inspiring and rewarding creativity is surely an effective elixir and a cure for our nation's current level of disengagement and complacency.

It is imperative that we make efforts to offer more tools to both small and large businesses to allow them to compete more effectively on a national and global business platform. Congressional initiatives, such as last year's DTSA and the 2013 America Invents Act (AIA) amendments to our nation's patent law systems, help provide entrepreneurs with a competitive edge. In order to keep our nation's job-creating engine well lubricated and running smoothly this

Committee should also explain similar regulations to address new technologies such as automation and robotics, copyright reform to keep up with developments in publishing and regulation, tax reform to encourage entrepreneurship and intrapreneurship, and patent troll legislation. This Committee must delve further into the root causes of the barriers that stand in the way of innovation, productivity, creativity and profitability, and be a catalyst for change and a champion and defender of those willing to undertake economic risks.

Common Barriers to Innovation

- Aversion to risk
- Politics (turfmanship)
- Red tape
- Pressure to live quarter to quarter (for public companies)
- Disconnect between innovation projects and overall strategic goals
- Communication silos
- Demand is unclear; Limited insights and inputs from customers
- Inadequate measurement tools & weak selection criteria
- Not enough ideas/creative focus within teams
- Lack of reward systems to motivate and encourage innovation
- Organizational chart: wrong people in the wrong jobs
- Time management constraints
- Lack of systems (how and where to start), focus, or resources
- Closed-mindedness
- Burn-out and Complacency
- Not Invented Here (NIH) syndrome
- Poor planning (or a lack of planning)
- Overly short-term investment horizons (public companies living in a fishbowl quarter to quarter)
- Inventor's syndrome (a better mousetrap vs. market/margin focused)
- Loss of touch with the needs and values of the end user/customer
- Inadequate skills (poor recruiting) or resources (weak capital structure)

Suggestions for Further Policy Research

We are living in a time of constant change and uncertainty. To protect and preserve the role of small businesses and entrepreneurs as drivers of economic growth and creators of new jobs, I respectfully suggest that this Committee consider the following areas for additional research and possible legislation or programming:

- Impact of Automation, Artificial Intelligence and Robotics on Small Business Job Creation, Retention, and Transformation
- Training, Education, and Incentives to Improve our Nation's Level of Employee Engagement
- Foster Access to the Capital Markets (Especially the Debt Markets by Allowing Smaller Companies to Pledge Intangible Assets as Collateral for Loans)
- Examine Intellectual Property Laws to Ensure Fair and Legitimate Opportunities to Harvest Intangible Assets and Restrict Patent Trolling
- Tax Reforms that Reward Measured Business Risks, Entrepreneurial Growth, and Exits to Foster Greater Wealth Creation
- Regulatory Reform to Unburden Small and Growing Business from the Costs that Prevent them from Being Competitive in a Global Marketplace (Consider Carrots v Sticks, Self-Regulatory Bodies, and Peer-Reviews, etc.)
- Replacing Certain Welfare Programs with Job Training and Mandatory Educational Programs to Keep our Workforce Relevant and Productive (Federal and State Welfare Programs Should Not be more Lucrative than Engaged Career Paths)

Summary

I have no doubt that dozens of very well-trained minds from academia, trade associations, research organizations, to industry leaders have previously appeared before this Committee. My perspectives are from the trenches and based on my experiences in working with thousands of entrepreneurs and small business owners over 32 years as a legal and strategic advisor. Our entrepreneurial ecosystem is one of the primary assets we all share as a nation in remaining competitive in a global marketplace. The role of our government is to allow it to flourish through the undue burden of regulation, to support it with creative initiatives that will fuel economic growth and new jobs, and to celebrate it by recognizing the day-to-day efforts of our nation's entrepreneurs and small business owners, who, like those who defend our county and those who serve as our emergency responders and educators, are our truest American heroes.

Testimony

Stephen Moore

Distinguished Visiting Fellow in Economics

The Heritage Foundation

April 27, 2017

On

The Intrinsic Value of Economic Growth

Mr. Chairman.

Thank you for the opportunity to testify before the Subcommittee on Economic Growth, Tax, and Capital Access on the intrinsic value of growth, and why I believe it is the single most important element to fixing many of the economic problems we currently face. My name is Stephen Moore and I am an economist at the Heritage Foundation. Neither I nor the Heritage Foundation receive any federal funding.

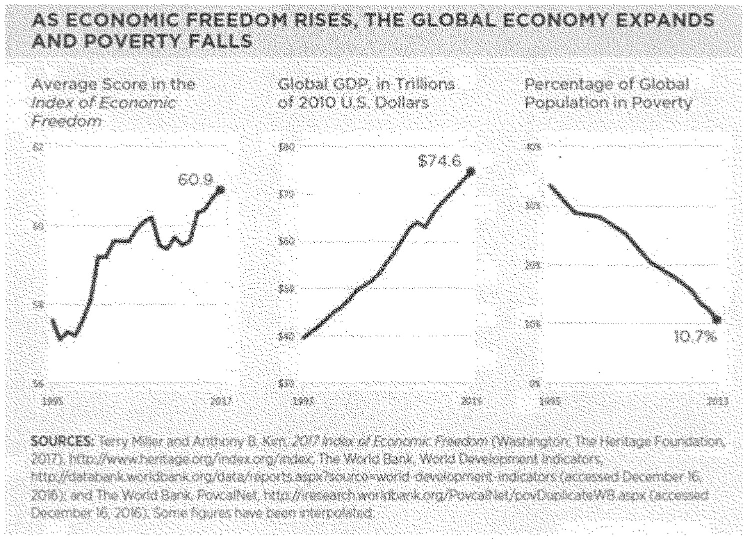
Over the last 8 years, economic growth has been stagnate. Wages are, for the most part flat, and many on the left believe our days of sustainable 3 percent growth are over. *CNN Money* recently asked leading economists about President Trump's desire to see 4 percent growth, and they found a strong consensus that it's "impossible, or at least highly unlikely." They say there aren't enough workers with the retirement of the baby boomers and that automation means fewer jobs available. Many point to the widely cited 2016 San Francisco Fed study which argues that the "new normal" is 1.5 to 1.75% GDP growth — or less than half the post-World War II average pace of progress.[1]

In addition, The CBO projects that America will see an average 1.9% annual growth over the next 30 years.[2] This represents a massive downgrade from historical performance. Between 1974 and 2001, average growth was 3.3%. An extra percentage point makes a world of difference.[3]

But when it comes to these devastating growth predictions, throughout modern history, they are outliers, and history sides with growth. Consider President Kennedy's call to cut taxes at the New York Economic Club to spur growth. After they were implements, the economy grew by 4.5 percent, and unemployment levels sank. The same is true for Reagan. After cutting taxes, the economy expanded by 4 percent from 1983-1989, putting to shame those who doubted 4 percent growth was possible.

[1] http://www.frbsf.org/economic-research/publications/economic-letter/2016/october/new-normal-for-gdp-growth/
[2] https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52480-ltbo.pdf, page 8
[3] https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52480-ltbo.pdf, page 9

Chart 1



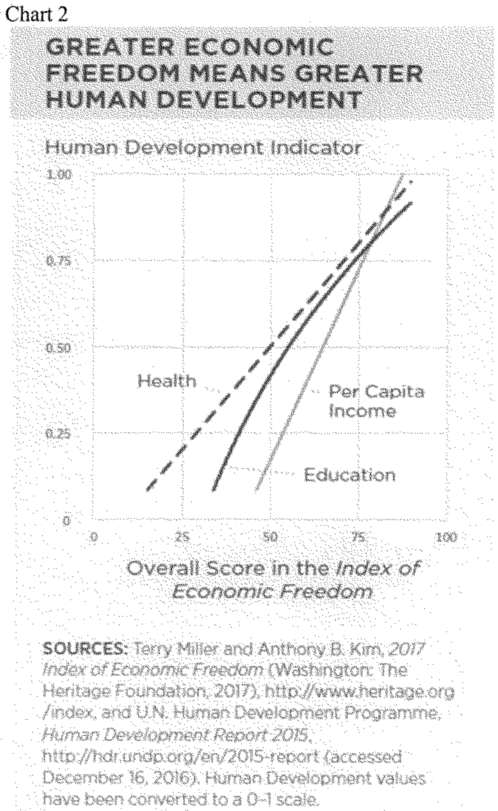
According to the Index for Economic Freedom and Opportunity published by The Heritage Foundation, "People in economically free societies have longer lives. They have better health and access to more effective education. They are able to be better stewards of the environment, and they push forward the frontiers of human achievement in science and technology through greater innovation." [4] I believe that the hope of human achievement, and policies that allow for us to produce and grow, free of government intervention will break all expert predictions. This is all possible is Congress enacts policies that reduce regulation, lower taxes, and empower small business expand beyond what we thought possible.

Take the miracle of Fracking. Over the last decade, America blew away expert predictions that we were running out of fossil fuels. Because of private sector ingenuity, America is on its way to becoming a dominant global energy producer. Thanks to fracking and horizontal drilling technologies, we are producing more natural gas than ever before. Natural gas is a wonder fuel: it

[4] http://www.heritage.org/index/book/chapter-1

is cheap. It is abundant. America has more of it than anyone else — we have several hundred years' worth of natural gas. And it is clean burning. It will only be stifled by government intervention, and regulations. (See chart 2)

Chart 2

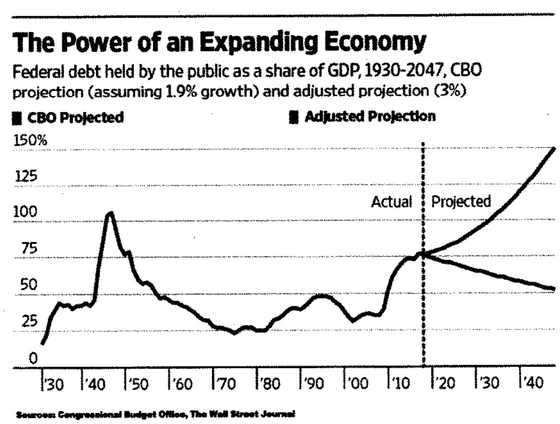


The recent CBO report paints a very bleak picture of what our economy will look like with a 1.9 percent growth rate over the next 30 years. But consider what happens to the CBO's numbers assuming 3% annual growth. By 2040 the economy would expand not to $29.9 trillion, but to $38.3 trillion, according to an analysis by Research Affiliates, a California investment firm. That's an additional output of $8.4 trillion.

By 2047, the economy would grow to $47.1 trillion, almost $13 trillion more than the CBO's baseline estimate. That would spin off new tax revenue to Washington of about $2.5 trillion each year. That money ought to be more than enough to pay all the bills and cover most of the unfunded costs of Social Security and Medicare.

Growth of 3% would stop the debt-to-GDP ratio from skyrocketing. Instead it would start to fall almost immediately, eventually to about 50%, because the economy would be so much larger. Congress and the White House ought to understand that what matters most for heading off a fiscal crisis is making sure that the economy grows faster than the government. No other debt-reduction policy—certainly not a tax increase—comes close to having the fiscal effect that sustained prosperity does. (See Chart 3)

Chart 3



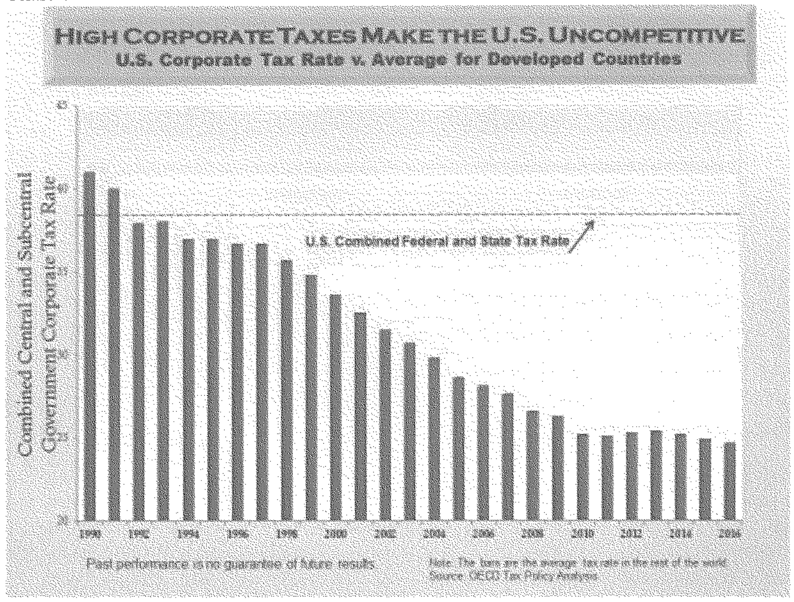
As discussed above, the greatest thing that government can do to encourage growth is to get out of the way and let business flourish. I propose a permanent reduction in the corporate/business tax rate from 35 percent to 15 percent. This should be accompanied by expensing for business capital purchases.

Apple and GE might bring back tens of billions of dollars for assembly plants and research centers on these shores. The current U.S. Rate of 35 percent (federal) is the highest of all the nations we compete with. The rest of the world is at a rate closer to 25 percent with some nations like Ireland as low as 12.5 percent. Let's go from the highest rate in the world to one of the lowest and jobs and capital flows will reverse course and rush back the United States.

We have seen companies like Burger King, Medtronics. Pfizer, and dozens more leave the U.S. in search of lower tax rates. In January Johnson Controls announced a merger and we could wind up with yet another American company leaving to reside in foreign nations.

Liberals like to pretend that the U.S. tax rates aren't chasing out businesses and jobs, but then why are all the nations we compete with slashing their rates? See chart 4. The international average has come down from almost 40% in 1990 to 25% today. For two and a half decades the U.S. rates haven't budged, while the rest of the world keeps chopping. We're like a 6th grader who stops growing and then goes out and tries to play competitive basketball with 20 year olds over six feet tall.

Chart 4



In sum, Congress should get ahead of these dire growth predictions by the CBO and pass reforms that encourage small business to flourish. Reforms like the ones above will increase revenues, and potentially spur growth unlike anything we've seen.

Finally, Mr. Chairman, I am very excited about the potential to see small business grow under your leadership here. I know you have for years expressed a commitment to fundamental tax reform and I believe you can get this done in the next couple of years. The last time tax reform happened was 30 years ago and Ronald Reagan helped clean out the stables of the tax code and chop the top tax rate to 28 percent with strong bi-partisan support. This can happen again with your leadership and vision and we at Heritage wish to continue to help every step of the way.

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Economic Growth: Causes, Benefits, and Current Limits

Testimony of Chad Stone, Chief Economist, Center on Budget and Policy Priorities, before the Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access, U.S. House of Representatives

April 27, 2017

Chairman Brat, Ranking Member Evans, and other members of the Committee, thank you for this opportunity to testify today about the causes of economic growth, the benefits associated with economic growth, and current limits on economic growth in the United States. These are important topics to understand better if we are to evaluate properly President Trump's bold claim that his policies will supercharge the economy and return us to the higher rates of growth we enjoyed in an earlier era.

My testimony makes four essential points:

- Growth matters both for fiscal stabilization and for raising living standards.
- Economic growth over the next decade will be much closer to the 2 percent average annual rate the Congressional Budget Office (CBO) projects than to the 3 percent or better the Trump Administration is promising.
- Large tax cuts are far from a surefire way to spur growth, higher taxes don't preclude growth, and tax cuts can harm growth if they add to the budget deficit or are paired with cuts to productive public investments.
- Small businesses are an important piece of the American economy, but in evaluating sources of growth, it's new businesses rather than small businesses *per se* that matter.

Why Growth Matters

Faster growth in gross domestic product (GDP) expands the *overall size* of the economy and strengthens fiscal conditions. Broadly shared growth in *per capita* GDP increases the typical American's material standard of living. But GDP is not meant to be a measure of economic welfare, and other considerations are important in fully assessing the costs and benefits of policy changes.

Estimates from both the Office of Management and Budget and CBO suggest that faster economic growth would improve the fiscal outlook. They find that a 0.1 percentage point increase in annual economic growth would reduce deficits by roughly $300 billion over a decade, mostly through higher revenues.[1] While *actually* boosting economic growth does reduce future budget deficits, all other things equal, ***making unrealistic growth claims*** for one's policies as a way to offset their cost will understate the adverse impact of those policies on actual future deficits.

Broadly speaking, there are two main sources of economic growth: growth in the size of the workforce and growth in the productivity (output per hour worked) of that workforce. Either can increase the overall size of the economy but only strong productivity growth can increase per capita GDP and income. Productivity growth allows people to achieve a higher material standard of living without having to work more hours or to enjoy the same material standard of living while spending fewer hours in the paid labor force.

GDP measures the market value of goods and services produced in the country, but it captures only market activity and is not designed to be a measure of economic welfare. A parent in the paid labor force contributes to GDP; one who stays home to take care of children or an aging family member does not, but, if the family hires someone to perform these same duties, that labor would contribute to GDP. Health, safety, and environmental regulations can impose costs on businesses that may slow measured GDP growth, but any such costs must be compared with the benefits of better health, safer workplaces, and a cleaner environment that may not be captured in GDP.

Finally, a full assessment of the benefits of economic growth requires consideration of how widely Americans share in that economic growth. There's a big difference between growth like that we experienced between 1948 and 1973, which doubled living standards up and down the income distribution, and the growth accompanied by widening income inequality we've experienced since.[2]

Sources of Economic Growth

CBO projects that, under current laws and policies, the economy will grow 2.3 percent this year but that growth will average just 1.9 percent a year between now and 2027.[3] As a candidate, President Trump boasted that his economic plan "would conservatively boost growth to 3.5 percent per year on average . . . with the potential to reach a 4% growth rate."[4] And Treasury Secretary Steven Mnuchin has said that under President Trump's policies, economic growth will pick up to "3

[1] Office of Management and Budget, "Economic Assumptions and Interactions with the Budget," *FY 2017 Budget, Analytical Perspectives*, Table 2-4, https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/ap_2_assumptions.pdf, and Congressional Budget Office, *The Budget and Economic Outlook: 2017 to 2027*, January 24, 2017, Appendix B, p.83, https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52370-appendixb.pdf .

[2] Chad Stone, et al., "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, updated November 7, 2016, http://www.cbpp.org/research/poverty-and-inequality/a-guide-to-statistics-on-historical-trends-in-income-inequality.

[3] Congressional Budget Office, *The Budget and Economic Outlook: 2017 to 2027*, January 24, 2017, Table C-1 and Summary Table 1, https://www.cbo.gov/publication/52370,.

[4] Fact Sheet: Donald J. Trump's Pro-Growth Economic Policy Will Create 25 Million Jobs, September 15, 2016, https://www.donaldjtrump.com/press-releases/fact-sheet-donald-j.-trumps-pro-growth-economic-policy-will-create-25-milli.

percent or higher."[5] Last week, Mnuchin said the President's economic plan would pay for itself with growth.[6]

It is not unusual for an administration's economic forecast to be somewhat more optimistic than CBO's, since the administration is presumably proposing policies it expects will improve economic performance over current laws and policies. But the gap between CBO's forecast and the numbers we are hearing from the Trump Administration is unusually large.

An economy recovering from a recession can temporarily achieve relatively high rates of "catch-up" growth as demand for goods and services rebounds from weak recession levels. Businesses can readily meet the rise in demand for their output by hiring unemployed workers and more fully utilizing productive capacity that had been idled by the recession. Once excess unemployment has been eliminated and capacity utilization is back to normal, however, the economy's growth rate is constrained by growth in its ability to supply goods and services.

Economists use the term "potential output" or "potential GDP" to describe the economy's maximum sustainable level of economic activity. Growth in potential GDP is determined by growth in the potential labor force (the number of people who want to be working when the labor market is strong) and growth in potential labor productivity. The potential labor force, in turn, grows through native population growth and immigration, while potential labor productivity grows through business investment in tangible capital (machines, factories, offices, and stores) as well as investments in R&D and other intangible capital. Improvements in labor quality due to education and training can also boost productivity, as can improvements in managerial efficiency or technology that allow businesses to produce more with the same amount of labor and capital.

Well-conceived tax, regulatory, and public investment policies can complement labor force growth and private investment in expanding potential GDP. They can also reap public benefits that GDP does not necessarily capture, such as distributional fairness and health and safety protections. Poorly conceived policies, of course, can impede growth and hurt national economic welfare.

Potential GDP represents the economy's maximum sustainable level of economic activity. Actual GDP falls short of potential GDP in a recession, when aggregate demand is weak; it can temporarily exceed potential GDP in a boom, when aggregate demand is strong. But, over longer periods, actual GDP and potential GDP tend to grow together.

The Great Recession produced a large output gap between actual and potential GDP, which narrowed only slowly over the next several years as the economy recovered from the recession. CBO projects that the remaining gap will be closed by the end of 2018 and that the major constraint on economic growth going forward will be the growth rate of potential output rather than weak aggregate demand.

[5] "Treasury Secretary Steven Mnuchin Sees Tax Overhaul by August," *Wall Street Journal*, February 22, 2017, https://www.wsj.com/articles/treasury-secretary-steven-mnuchin-pushes-hard-for-stronger-dollar-1487798404

[6] "Trump's treasury secretary: The tax cut 'will pay for itself'," *Washington Post*, April 20, 2017, https://www.washingtonpost.com/news/wonk/wp/2017/04/20/trumps-treasury-secretary-the-tax-cut-will-pay-for-itself/?utm_term=.1290bd4ccc05.

CBO estimates that potential GDP will grow at an average annual rate of a little under 1.9 percent over the next decade. About 0.5 percentage points of that growth comes from increases in the potential labor force and about 1.3 percentage points comes from increases in labor productivity. These projections of labor force and productivity growth are each lower than those that produced 3.2 percent average annual growth in potential GDP between 1950 and 2016 (see Figure 1).

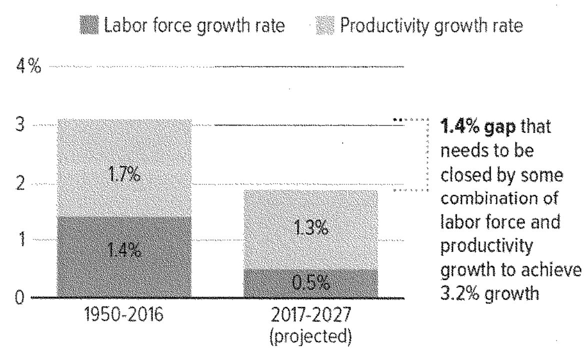
Conditions are different now. The population is aging and, without more immigration, the potential labor force will grow much more slowly than when baby boomers were flooding the labor market. Productivity also grew much faster during the "golden age" of economic growth in the generation after World War II and in the late 1990s than CBO projects it will grow in coming years — and the benefits of that productivity growth were shared more equally than they have been recently. Trump policies would have to produce some combination of stronger labor force participation and productivity growth totaling 1.4 percentage points to match the 3.2 percent historical average.

Economist Edward Lazear, Chairman of President George W. Bush's Council of Economic Advisers, attempted in a recent *Wall Street Journal* op-ed to explain how this might happen.[7] Like the Trump team, Lazear touted the purported benefits of "investment-friendly tax policy" and business relief from "burdensome" regulations. However, he concluded that achieving such a high growth rate is "unlikely."

FIGURE 1

3.2% Not a Realistic Target for Future Growth

Percent contributions to average annual growth in potential GDP



Note: Data may not sum to total due to rounding.
Source: Actual and projected growth figures from Congressional Budget Office

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[7] Edward P. Lazear, "How Trump Can Hit 3% Growth—Maybe," *Wall Street Journal*, February 27, 2017, https://www.wsj.com/articles/how-trump-can-hit-3-growthmaybe-1488239746.

Tax Cuts and Economic Growth

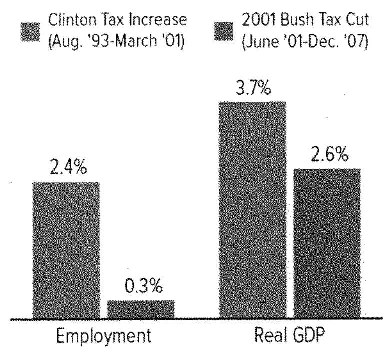
Exaggerated claims for the economic growth benefits of large tax cuts have been around since the emergence of supply-side economics in the late 1970s and persist to this day. But there's scant evidence to support, for example, House Speaker Paul Ryan's claim that cutting tax rates across the board is the "secret sauce" that generates faster economic growth, more upward mobility, and faster job creation or Treasury Secretary Mnuchin's claim that the Trump economic plan will pay for itself through growth. What the evidence shows is that tax cuts — particularly for high-income people — are an ineffective way to spur economic growth, and they're likely to *harm* the economy if they add to the deficit or are paired with cuts to investments that support the economy and working families.[8]

History shows that tax cuts for the rich are far from a surefire way to boost growth — and that higher taxes don't preclude robust economic and job growth. Compare, for example, changes in employment and economic growth following the Bush tax cuts of 2001 with those following the Clinton tax increases on high-income taxpayers in 1993, which supply-siders were certain would lead to slower growth and large job losses (see Figure 2). Small business job-creation was also more robust under Clinton. After the Bush tax cuts for the very highest-income households expired at the end of 2012, the economy continued to grow and add jobs steadily.

FIGURE 2

Tax Cuts Didn't Supercharge Growth in the Bush Era

Cumulative annual growth rate in period following tax change



Note: Additional tax cuts were passed in 2003. Analysis ends the Bush tax cut period in December 2007 because the Great Recession began afterwards.

Source: CBPP analysis based on data from Bureau of Labor Statistics and Bureau of Economic Analysis.

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In a comprehensive review of the literature, economists Bill Gale and Andrew Samwick conclude that "growth rates over long periods of time in the U.S. have not changed in tandem with the massive changes in the structure and revenue yield of the tax system that have occurred."[9]

When Kansas enacted large tax cuts overwhelmingly for the wealthy, Gov. Sam Brownback claimed the tax cuts would act "like a shot of adrenaline into the heart of the Kansas economy." But rather than seeing an economic

[8] "Tax Cuts for the Rich Aren't an Economic Panacea — and Could Hurt Growth," Center on Budget and Policy Priorities, April 13, 2017, http://www.cbpp.org/research/federal-tax/tax-cuts-for-the-rich-arent-an-economic-panacea-and-could-hurt-growth.

[9] Andrew A. Samwick and William G. Gale "Effects of Income Tax Changes on Economic Growth, Brookings Institution, February 1, 2016, https://www.brookings.edu/research/effects-of-income-tax-changes-on-economic-growth/ .

boom since the tax cuts, Kansas' growth — including small business job growth, economic growth, and growth in small business formation — has lagged behind the country as a whole.[10]

These simple relationships are not controlled experiments to isolate the effect of tax cuts on growth, but they are a warning against credulous acceptance of supply-side claims. Careful economic research reinforces that conclusion. It finds that tax cuts on high-income people's earnings or their income from wealth (such as capital gains and dividends) don't substantially boost work, saving, and investment.

They are likely to *hurt* growth if they increase deficits or are paired with cuts to investments that help working families and the economy. CBO, which aims to provide objective, impartial, and non-partisan analysis reflecting expert opinion, finds that even tax cuts that increase incentives to work, save, and invest with potentially positive effects on growth are a net drag on growth if they increase the budget deficit.

Financing tax cuts for the rich by cutting productive public investments that help support growth, such as education, research, and infrastructure, are also harmful. Finally, a growing body of research suggests that investments in children in low-income families not only reduce poverty and hardship in the near term, but can have long-lasting positive effects on their health, education, and earnings as adults.

Unless it is dramatically different from candidate Trump's tax plan or the House "Better Way" plan, the tax plan President Trump is working on will provide massive tax cuts that overwhelmingly benefit high-income taxpayers and lose huge amounts of revenue. That's certainly true under conventional revenue-estimating methods used by Congress's official budget scorekeepers, CBO and the Joint Committee on Taxation (JCT).

It's also true under most "dynamic scoring" that takes into account macroeconomic feedback effects on economic growth and revenues. The Tax Foundation, to whose analysis supply-siders gravitate, is an outlier with respect to dynamic scoring.[11] It tends to find significantly larger dynamic effects for tax proposals than CBO or JCT have found in their own past analyses, and significantly larger effects than the Tax Policy Center/Penn Wharton model finds in its analyses of the Trump[12] and Better Way[13] proposals. But even the Tax Foundation's Alan Cole rejects the idea that Trump tax policies could produce enough economic growth to pay for themselves.[14]

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[10] "GOP Tax Plans Would Emulate Failed Kansas Experiment," Center on Budget and Policy Priorities, April 21, 2017, http://www.cbpp.org/research/federal-tax/gop-tax-plans-would-emulate-failed-kansas-experiment .

[11] Chad Stone and Chye-Ching Huang, "Trump Campaign's 'Dynamic Scoring' of Revised Tax Plan Should Be Taken With More Than a Grain of Salt," CBPP, September 15, 2016," http://www.cbpp.org/research/federal-tax/trump-campaigns-dynamic-scoring-of-revised-tax-plan-should-be-taken-with-more

[12] Jim Nunns, Len Burman, Jeff Rohaly, and Joe Rosenberg, "An Analysis of Donald Trump's Revised Tax Plan," Tax Policy Center, October 11, 2016," http://www.taxpolicycenter.org/publications/analysis-donald-trumps-revised-tax-plan/full

[13] Leonard E. Burman, James R. Nunns, Benjamin R. Page, Jeffrey Rohaly, Joseph Rosenberg, "An Analysis of the House GOP Tax Plan," Tax Policy Center, April 5, 2017, http://www.taxpolicycenter.org/publications/analysis-house-gop-tax-plan-0 .

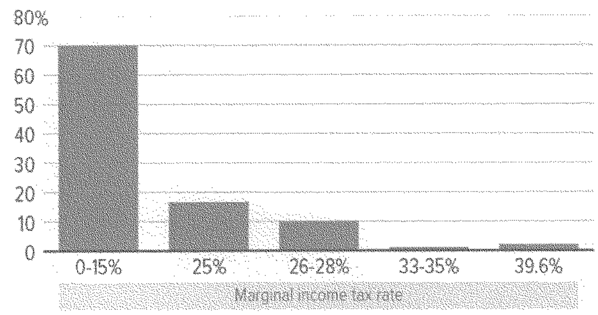
[14] Alexia Fernández Campbell *and* Dylan Scott, "Trump wants a "massive" tax cut. Here's his best shot at getting it,"Vox.com, April 25, 2017, http://www.vox.com/policy-and-politics/2017/4/25/15383806/trump-white-house-tax-plan-budget-math .

A centerpiece of President Trump's campaign tax proposal and the Better Way tax plan is a special, much lower top rate for "pass-through" business income — which is currently taxed at owners' individual income tax rates rather than the corporate rate and as dividend income in the hands of shareholders. About *half* of pass-through income flows to the top 1 percent of households, while only about 27 percent goes to the bottom 90 percent of households.[15]

These proposals would cut the top rate on pass-through income below the top rate on ordinary income (to 15 percent and 25 percent respectively), giving wealthy individuals a strong incentive to reclassify their wage and salary income as "business income" to get the lower pass-through rate. This would produce a substantial loss in revenue, while providing no benefit to the vast majority of small businesses, whose tax rate would be unaffected (see Figure 3).

FIGURE 3

Most Pass-Through Filers Are Already Taxed at Lowest Individual Tax Rates



Note: Pass-through income is business income that individuals report on their individual tax returns. Includes only tax units reporting net positive business income in 2016.

Source: Tax Policy Center Table T16-0185

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The beneficiaries don't fit anyone's reasonable definition of a small business. They include hedge fund managers, consultants, and investment managers, who are among the pass-through business owners currently in the 39.6 percent tax bracket; the 400 highest-income taxpayers in the country, who have annual incomes exceeding $300 million each and receive about one-fifth of their income from pass-throughs; and business owners like President Trump, who owns about 500 pass-through businesses, according to his attorneys.

Kansas Gov. Sam Brownback exempted pass-through income from all state income taxes as part of his aggressive supply-side tax cutting in 2012. As I've already noted, this did nothing for the Kansas economy, but it wreaked havoc on the state's budget, with the pass-through exemption

[15] "Pass-Through Tax Break Would Benefit the Wealthiest and Encourage Tax Avoidance," Center on Budget and Policy Priorities, April 5, 2017, http://www.cbpp.org/research/federal-tax/pass-through-tax-break-would-benefit-the-wealthiest-and-encourage-tax-avoidance

alone costing $472 million in 2014, leading Kansas to cut services, drain "rainy day" funds, delay road projects, and turn to budget gimmicks. Two bond rating agencies have downgraded the state due to its budget problems. The Kansas legislature recently passed bipartisan legislation to close the loophole, although Gov. Brownback vetoed the bill.

That's an object lesson in how not to do tax reform, but what should we do? In broad strokes, well-designed tax reform could spur growth by eliminating or scaling back inefficient tax subsidies and raising additional revenues to invest in national priorities and reduce deficits. At a minimum, it must not lose revenues.[16]

A Word about Small Business

As I'm sure many on this committee are aware, research over the last several years has modified the longstanding claim that small businesses are the engine of job growth. This research shows that the age of a business matters more than its size as a contributor to job growth, although new companies are typically small to start with. Every year there is huge turnover in the population of small businesses as firms fail or go out of business and new firms start up. To quote one of the pioneers in this research:

> Most entrants fail… [M]ost surviving young businesses don't grow. But a small fraction of surviving young businesses contribute enormously to job growth. A challenge of modern economies is having an environment that allows such dynamic, high-growth businesses to succeed. [17]

[16] Paul N. Van de Water, "Tax Reform Must Not Lose Revenues — and Should Increase Them," Center on Budget and Policy Priorities. April 20, 2017, http://www.cbpp.org/research/federal-tax/tax-reform-must-not-lose-revenues-and-should-increase-them .

[17] https://www.richmondfed.org/~/media/richmondfedorg/publications/research/econ_focus/2013/q2/pdf/interview.pdf