

REACHING AMERICA'S POTENTIAL: DELIVERING  
GROWTH AND OPPORTUNITY FOR ALL  
AMERICANS

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HEARING  
BEFORE THE  
COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED FOURTEENTH CONGRESS

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**REACHING AMERICA'S POTENTIAL:  
DELIVERING GROWTH AND OPPORTUNITY  
FOR ALL AMERICANS**

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**TUESDAY, FEBRUARY 2, 2016**

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
*Washington, DC.*

The Committee met, pursuant to call, at 10:05 a.m., in Room 1100, Longworth House Office Building, the Honorable Kevin Brady [Chairman of the Committee] presiding.  
[The advisory announcing the hearing follows:]



### **Brady Announces First Committee Hearing of 2016**

*Reaching America's Potential: Delivering Growth and Opportunity for All Americans*

#### **\*HEARING RESCHEDULED\***

All other details remain unchanged

Today, Ways and Means Committee Chairman Kevin Brady (R-TX) announced that the Committee will hold its first hearing of the year on Tuesday, February 2<sup>nd</sup> at 10:00 AM, in Room 1100 Longworth House Office Building. The hearing will focus on reaching America's potential through pro-growth policies that deliver opportunities for all Americans.

#### **Details for Submission of Written Comments:**

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Tuesday, February 16<sup>th</sup>, 2016**. For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-2610.

#### **Formatting Requirements:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.
3. Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

**Note:** All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>.

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Chairman BRADY. The committee will come to order.

Welcome to the Ways and Means Committee hearing on “Reaching America’s Potential: Delivering Growth and Opportunity for All Americans.” I thank you all for joining us today.

We are holding this hearing today because we want the American people to clearly understand the members of this committee are focused on their number one concern, the economy. This is what we hear about at home, and this is what we will take action on in Washington. For over 7 years, Americans watched in disappointment as the Obama White House has settled for slow growth. Time and time again, the President has refused to support bipartisan, commonsense policies that can improve the lives of millions of people across the country.

And, today, February of 2016, we remain in the middle of the worst recovery in the post-war era. The fact is, if the speed of this recovery simply matched the post-1973 average, GDP per person would be 7.5 percent. That is a full \$4,200 per person higher than it is today. That is about \$17,000 for a family of four.

While the economists in the room love to hear these numbers and percentages, I will take a moment to talk about what this means to the rest of us. With growth well below historic norms, productivity growth is near zero, and wage growth is flat. Median household incomes are down. That is no surprise to most Americans. Forty-six million Americans are living in poverty, including millions in the prime of their life who are sitting on the sidelines without work.

The American people deserve better, and Washington doesn’t have any more time to waste. I could spend the next hour discussing the failed policies of the past, but I won’t. The American people need us to focus on what we can do today to make their to-

tomorrow better. And as members of the Ways and Means Committee, we have a responsibility to deliver real leadership.

We are committed to moving forward with a positive pro-growth agenda for America. And in the weeks and months ahead, we will take action on tax reforms to boost investment and job creation; welfare reforms to help more people join the workforce and achieve the American dream; health reforms to truly make healthcare more affordable and accessible; trade expansion to open more foreign markets to American goods and services; entitlement reforms to strengthen Medicare and Social Security for the long haul; and government reforms to boost efficiency and effectiveness instead of stifling jobs and higher wages. Each of these steps will go a long way toward delivering the growth and opportunity all Americans need and expect.

Today we are going to hear from a range of respected economic advisors about specific actions that we can take to ensure America reaches its full potential. I am honored to welcome Douglas Holtz-Eakin of the American Action Forum, Kevin Hassett of the American Enterprise Institute, Jared Bernstein of the Center On Budget and Policy Priorities, and Stephen Moore of the Heritage Foundation. You are all leaders in your field, and you all understand we can't accept the slow growth status quo.

So growth matters. We have to take action to grow our economy. We have to take action to make it easier for the private sector, for Main Street, to create jobs. We have to take action to help Americans keep more of their hard-earned paychecks. Simply put, we have to take action.

So thank you again for joining us, and I now yield to the distinguished Ranking Member from Michigan, Mr. Levin, for the purposes of an opening statement.

Mr. LEVIN. Thank you very much, Mr. Chairman.

And to the distinguished panel, we are glad you are here, and we are glad we are discussing this issue.

The chairman talked about failed policies. I want to see if technology will work and put something on the screen there. There we go.

This screen, this slide vividly illustrates failed policies. Before President Obama took office, that month, this country lost between 700,000 and 800,000 jobs in a month. All of that red is because of the failed policies of the previous administration. What has happened since? Over 14 million jobs have been created. Seventy straight months of growth. The unemployment rate has been essentially cut in half. And the annual deficit has gone down substantially. And over 18 million people have been insured.

Essentially what is being proposed here by the Republican majority is this: The President inherited a deep hole, a deep, deep hole, the deepest since the Great Depression. Since then, we have essentially been digging out of it, and now it is being proposed in this testimony and by the Republican majority, go back to the failed policies, trickle-down economics, essentially digging the hole deeper and deeper.

We have an issue of income inequality. The Republicans have failed—though they have dominated in this town—to do a single thing to address income inequality, except to propose more tax cuts

for the very wealthy. And if there is an inversion, as taken place recently, where essentially a corporation is not moving anything except its headquarters to a different place to escape taxation, the answer from this Republican majority is, at best, kind of a blank stare.

So the answer is not to return to the failed policies of the past, but to build on the progress that we have been making all of these months.

So we welcome this panel, and you can expect very much that there will be some very important questions. I think we are going to hear a lot about dynamic scoring from one or more of you. And I finish by quoting Bruce Bartlett, and he says this about all of the talk about dynamic scoring, which essentially, I think, is an effort to kind of cover up policies that will mainly increase income inequality in this country, and he says: It is not about honest revenue estimating; it is about using smoke and mirrors to institutionalize Republican ideology into the budget process.

That chart shows the consequences of that institutionalization. And the last thing we need to do is to go back to the past as we face the future; it is to build on the progress that we have made these last 7 years.

I yield back.

Chairman BRADY. Without objection, other members' opening statements will be made part of the record.

Today's witness panel includes four experts on the U.S. economy and the importance of promoting economic growth. Douglas Holtz-Eakin is president of the American Action Forum. From 2001 to 2002, he was the Chief Economist on President Bush's Council of Economic Advisers. From 2003 to 2005, he served as the Director of the Congressional Budget Office.

Kevin A. Hassett is the State Farm James Q. Wilson Chair in American Politics and Culture at the American Enterprise Institute. He is also a resident scholar and AIE's director of economic policy studies. He served as a policy consultant in the U.S. Department of Treasury during the George H.W. Bush and Bill Clinton administrations.

Jared Bernstein is the senior fellow at the Center of Budget and Policy Positions. From 2009 to 2011, he was the Chief Economist and Economic Advisor to Vice President Joe Biden, Executive Director of the White House Task Force on the Middle Class, and a member of President Obama's economic team.

Stephen Moore is a distinguished visiting fellow, Project for Economic Growth at the Heritage Foundation. He has written on the economy and public policy for The Wall Street Journal. He was also a member of the Journal's editorial board.

The committee has received your written statements. They will all be part of the formal hearing record. You each have 5 minutes to deliver your oral remarks.

We will begin with Mr. Holtz-Eakin. Welcome back to our committee. And you can begin when you are ready, sir. Thank you.

**STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT,  
AMERICAN ACTION FORUM**

Mr. HOLTZ-EAKIN. Well, thank you Chairman Brady, and my congratulations to you. Ranking Member Levin and Members of the Committee, it is an honor to be here today.

In my opening remarks, I will make three points. The first is that America has a growth problem, and the poster child for this is that the Congressional Budget Office has pegged the long-term potential for economic growth at 2 percent, which is below the average pace of the economic recovery, and so these are literally the good times, according to those numbers.

The second point is that to address the growth problem, the committee needs to examine supply-side structural changes that either cause faster labor force growth or enhanced productivity growth.

And my third point is there are, within the jurisdiction of this committee, potential reforms in trade, in taxes, and entitlements that can be useful in boosting the long-term rate of economic growth.

Let me talk a little bit about each in turn.

First, a way to think about the growth problem is this: In the post-war period up to 2007, growth averaged 3.2 percent a year, which when you combined with population growth meant that GDP per capita, roughly a measure of the standard of living income per person, doubled every 35 years. So in a single working career, you could imagine the standard of living doubling: people buying a home for the first time, sending kids to school, whatever that might be.

If the CBO is right about its 2 percent projection and with population projections, it will take 70 years for the standard of living to double, and not in one working career, but in two, you might get back to the same kind of advances that Americans have been used to. Addressing that problem I think is central to the policy challenges that face the country.

It would also help with some other things that the committee is quite familiar with, and that is the fiscal outlook for the Federal budget, right. As the CBO just pointed out in its baseline projections, we are on an unsustainable trajectory. We have been so for some time. Improvements in the economic growth will not solve this by itself. You can't grow your way out of this problem, but every 10th of a percentage point translates into roughly \$300 billion, \$325 billion in budgetary improvement over 10 years. And having better growth makes addressing these other challenges much, much easier. It is important for that reason.

The second key point is you need to do supply-side productivity and labor-force-enhancing reforms to get better growth performance. This is literally by definition not an issue of stimulus or any of the kinds of things we have talked so much about in recent years. This is about the long-term rate of economic growth independent of business cycles. And they can only be addressed by things that raise the growth rate of either the number of workers, the labor force, or the output per worker, the income that they can produce, productivity. And those two things should be the focus of the committee's thinking: What can we do in the way of permanent changes to enhance labor force growth and/or productivity growth?

And because these are long-term issues, you should be thinking hard about structural changes, permanent changes, not temporary policies that might alter incentives for a short time.

Third is that there are some obvious areas where the committee, I think, should focus. The first would be in social safety net entitlements and efforts to make them more pro-work in every dimension. This morning my institution, the American Action Forum, released an analysis of a proposal by Speaker Ryan to enhance the earned income tax credit for those who do not have children. Doubling the childless EITC, in our estimates, would bring about a little over 8 million people into work in the United States. That is an enormous improvement. It would cost roughly \$1,700 in taxpayer dollars per job created, which is way better than anything we have heard about in terms of job creation. And we know that the dividing line between the poor and the not poor in America is those who work, and any pro-work improvements of that type are things that the committee should be pursuing. Those are things that you could pursue.

The trade agenda. Opening markets to trade is a crucial part of growth. Scale of market access helps our companies and our workers. The benefits of competition: enhanced productivity. It is no surprise that the high-productivity jobs are in the export sector, and that is where the high wages are.

Tax reform I am sure we will get a chance to talk a lot about, but these are ways to increase the efficiency of the existing capital, augment capital, whether it is in innovative forms, in physical forms, or in the skills of workers. And most testaments indicate you could add as much as a half percentage point—I think that is the upper bound—over 10 years to the growth rate of the economy.

And then the final one, which is I think crucial, is entitlement reform. Again, in the budget projections, entitlements are driving the large and unsustainable deficits in the future. That is not a pro-growth strategy. And on top of it, those entitlements are not serving the beneficiaries very well. So we can get a more durable social safety net, one that doesn't endanger the pace of economic growth and serves the beneficiaries better, and that is an agenda that I would recommend to the committee.

So I thank you for the chance to be here today, and I look forward to your questions.

Chairman BRADY. All right. Thank you very much.

[The prepared statement of Mr. Holtz-Eakin follows:]

Addressing the Growth Challenge

United States House of Representatives  
Committee on Ways and Means

Douglas Holtz-Eakin, President\*  
American Action Forum

February 2, 2016

\*The views expressed here are my own and not those of the American Action Forum. I thank Gordon Gray, Jacqueline Varas, and Chris Holt for their assistance.



Chairman Brady, Ranking Member Levin, and members of the Committee, thank you for the opportunity to speak with you today regarding the essential task of reigniting long-term economic growth in the United States. I would like to frame discussion of this imperative in three parts:

- Placing the nation's current growth challenge in the context of historical experience;
- Assessing the implications of improved economic performance on the federal budget; and
- Suggesting areas of policy reforms with the promise of enhancing future economic growth.

#### **Economic Growth: Past and Present<sup>1</sup>**

The nation has experienced a disappointing recovery from the most recent recession and confronts a projected future defined by weak economic growth. Left unaddressed, this trajectory will result in failing to bequeath to the next generation a more secure and more prosperous nation.

**Figure 1: Disappointing Economic Growth**

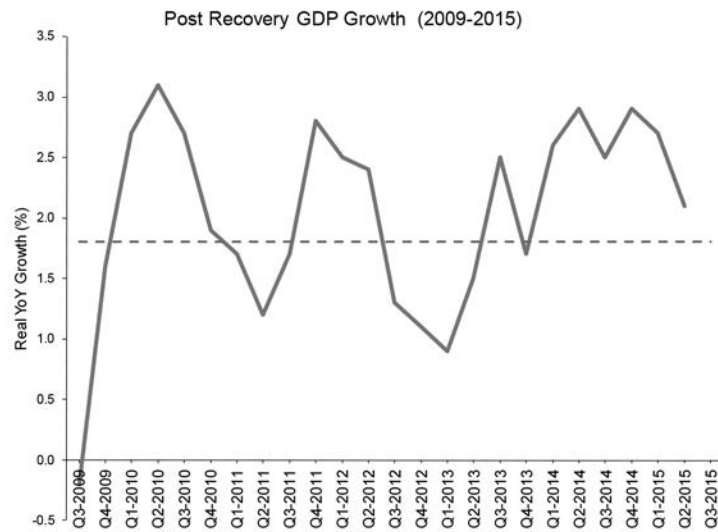
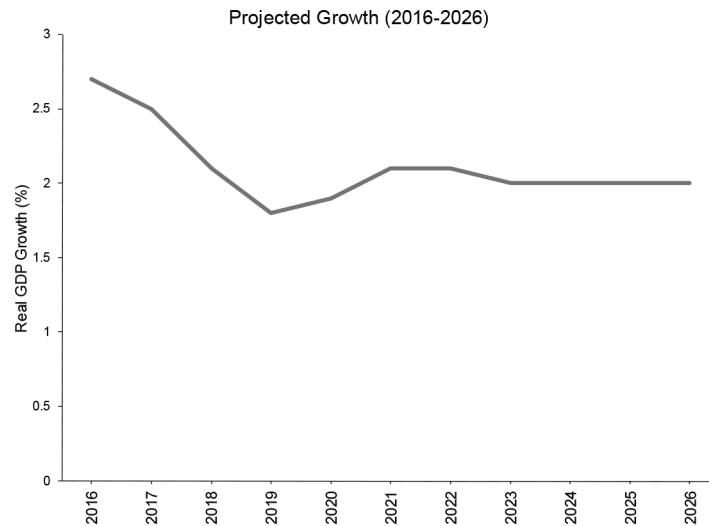


Figure 1 shows quarterly, year-over-year growth rates for real Gross Domestic Product (GDP) since the “official” end of the Great Recession in June of 2009. As displayed, real GDP growth has been stubbornly weak, averaging 1.8 percent (the dotted line). While it is generally understood that recoveries from recessions precipitated by financial crises tend to be weaker, the persistence of the nation’s weak economic recovery should not be written off as inevitable, but rather as a failure of economic policy.

**Figure 2: CBO January Baseline**



Even more troubling than the recent past is the outlook. The Congressional Budget Office (CBO) projects U.S. economic growth to average only 2.1 percent over the next decade – consistent with the tepid recovery seen since the third quarter of 2009. This rate of growth is below that needed to improve the standard of living at the pace typically enjoyed in post-war America.

During the early postwar period, from 1947 to 1969, trend economic growth rates were quite rapid. GDP and GDP per capita grew at rates of 4.0 percent and 2.4 percent, respectively. Over the subsequent two and one-half decades, however, these fell to 2.9 percent and 1.9 percent, respectively.

During the years 1986 to 2007, trend growth in GDP recovered to 3.2 percent, while trend GDP per capita growth rose to 2.0 percent. These were rates quite close to the overall historic performance for the period. These distinct periods and trends should convey that the trend growth rate is far from a fixed, immutable economic law that dictates the pace of expansion, but rather subject to outside influences including public policy.

More rapid growth is not an abstract goal; faster growth is essential to the well-being of American families.

**Table 1: The Importance of Trend Growth to Advancing the Standard of Living**

| <b>Trend Growth Rate Per Capita (%)</b> | <b>Years for Income to Double</b> |
|-----------------------------------------|-----------------------------------|
| 0.50                                    | 139                               |
| 0.75                                    | 93                                |
| 1.00                                    | 70                                |
| 1.25                                    | 56                                |
| 1.50                                    | 47                                |
| 1.75                                    | 40                                |
| 2.00                                    | 35                                |
| 2.25                                    | 31                                |
| 2.50                                    | 28                                |
| 2.75                                    | 26                                |
| 3.00                                    | 23                                |

The trend growth rate of postwar GDP per capita (a rough measure of the standard of living) has been about 2.1 percent. As Table 1 indicates, at this pace of expansion an individual could expect the standard of living to double in 30 to 35 years. Put differently, during the course of one's working career, the overall ability to support a family and pursue retirement would become twice as large.

In contrast, the long-term growth rate of GDP in the most recent CBO projection is 2.0 percent. When combined with population growth of 1.0 percent, this implies the trend growth in GDP per capita will average 1.0 percent. At that pace of expansion, it will take 70 years to double income per person. The American Dream is disappearing over the horizon.

The dramatic difference in aspirations, opportunities and achievement between a "2.1 percent per capita economy" and a "1.0 percent per capita economy" should be cause for national concern. Raising the trend rate of growth is central to retaining the American dream and the nation's place on the globe.

Any rapidly improving average standard of living should be shared broadly. Despite assertions to the contrary, that has been the historic norm in the U.S.<sup>2</sup> More recently, there

have been numerous assertions that the labor market is “broken” and that there is a disconnect between labor productivity and compensation that has only grown over time. This purported disparity has been used to justify an ever-growing menu of policies that includes a higher minimum wage, increased unionization, and other similar labor policies. Fortunately for workers, this disconnect is a myth. Calculated correctly, compensation has tracked worker productivity, belying the notion that broad economic growth is not broadly shared.<sup>3</sup>

### **Economic Growth and the Federal Budget**

A second benefit of improved economic growth is budgetary. The federal government faces a problematic budgetary future, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office’s (CBO’s) Long-Term Budget Outlook. In broad terms, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to nearly 40 percent of GDP. Any attempt to keep taxes at their post-war norm of about 18 percent of GDP will generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, lasting action (in the right direction) has yet to achieve the force of law.

In the past several years, the outlook has worsened significantly.

Over the next ten years, according to the CBO’s latest baseline projections, the deficit will average over \$900 billion. Ten years from now, in 2026, the deficit will be \$1.3 trillion. As a result of the nation’s irresponsible spending binge, in 2026 debt held by the public will have more than doubled from its pre-financial crisis level in 2007 to over 80 percent of GDP and will continue its upward trajectory.

High levels of indebtedness, coupled with weak projected growth, crowd out productive investment and further suppress economic growth. This combination eventually leads to a spiral of higher interest rates, debt service payments, and damaging fiscal policy. Within the current budget window, borrowing roughly equals interest payments, meaning the existing debt portfolio is already constraining policymakers and jeopardizes the budget’s capacity to absorb another recession or geopolitical crisis.

Despite the nation’s significant budgetary challenges, even incrementally higher economic growth can ameliorate the fiscal outlook by increasing taxable income and suppressing reliance on the social safety net. According to the CBO, a persistent 0.1 percentage point

increase in the real growth rate translates into about \$300 billion in budget savings.<sup>4</sup> A robust pro-growth agenda could realize multiples of this “rule of thumb” in deficit reduction.

### **A Pro-Growth Policy Agenda**

We should not settle for 2 percent growth as the new normal, forgoing rising wages for American families, but rather embark on a pro-growth policy agenda. The elements of this agenda should touch on every element of public policy. Within the Committee’s purview, the Congress and the administration should further pursue sound trade policy, entitlement reform and a comprehensive overhaul of the nation’s tax code.

#### ***Trade Agreements***

Trade is an important driver of productivity and economic growth in the U.S. and globally. Trade creates jobs, increases GDP, and opens markets to American producers and consumers. The U.S. is the world’s largest participant in global trade—with \$1.4 trillion in exports of goods and services and imports of over \$2 trillion—and has established free trade agreements with 20 countries.<sup>5</sup> The U.S. is the largest exporter of services in the world.<sup>6</sup> Trade supports over 11 million jobs in the U.S.<sup>7</sup> and U.S. exports comprise a full 13 percent of U.S. GDP<sup>8</sup>.

These numbers are significant, and pursuing a robust trade agenda in 2016 offers the opportunity for improved economic growth. The Trans-Pacific Partnership (TPP), finalized in 2015, was promised to be a pro-growth trade agreement. I appreciate the Committee’s and Congress’ exercise of its oversight authority granted in the Trade Promotion Act to ensure that TPP as agreed-to remains sound trade policy.

Two other trade agreements, the Transatlantic Trade and Investment Partnership (TTIP) and Trade in Services Agreement (TiSA), are currently being negotiated and offer opportunities for expanding global markets. TTIP would fully open EU markets, boost GDP by \$125 billion, and create more than 740,000 U.S. jobs.<sup>9</sup> TiSA, the first trade agreement in services since 1995, could bind together 75 percent of the world’s \$44 trillion services market.<sup>10</sup> If effectively negotiated, these agreements offer significant economic potential.

#### ***Tax Reform***

The U.S. tax code is broadly viewed as broken and in need of repair, and for good reason – it hasn’t been overhauled in 30 years. Whereas the administration would instead make the tax system worse – adding higher rates and new taxes, including on the middle class – the

Committee should pursue a fundamental overhaul of the nation's tax system.<sup>11</sup> A sound reform of the U.S. tax code is an essential element of any pro-growth strategy, and could substantially increase trend economic growth, boosting the economy and tax revenue.<sup>12</sup>

Fundamental modernization and simplification of the tax system has been an elusive dream for Congresses and administrations over the past 30 years, and a wholesale reform of the code is invariably difficult during an election. This committee is to be commended, however, for its recent contributions to this effort, including the recent tax legislation that enshrines current policy as current law and grants more clarity to the nation's revenue outlook.<sup>13</sup>

The last time the United States undertook a fundamental tax reform was with the Tax Reform Act of 1986 (TRA). If history is any guide, a 1986 style reform offers faster economic growth. This is borne out by retrospective analysis of the TRA which found that the 1986 tax reform produced about one percentage point higher growth over a long period. Further studies have shown that the negative relationship with higher marginal rates and taxable income, hours worked, and overall economic growth.<sup>14</sup>

A more robust reform offers even greater growth benefits. Highly respected economists David Altig, Alan Auerbach, Laurence Kotlikoff, Kent A. Smetters, and Jan Walliser, simulated multiple tax reforms and found GDP could increase by as much as 11 percent from tax reform.<sup>15</sup> The highest growth rate was associated with a consumption-based tax system that avoided double-taxing the return to saving and investment. The study also simulated a "clean," revenue-neutral income tax that would eliminate all deductions, loopholes, *etc.*; and lower the rate to a single low rate. According to their study, this reform raised GDP by 5.1 percent over ten years—a growth effect that roughly translate into about 0.5 percent higher trend growth, resulting in faster employment and income growth. Gains of this order are achievable through the types of reform efforts that could come before this Committee.

### ***Entitlement Reform***

Entitlement reform is perhaps the most important issue for the Congress. Inexorable increases in entitlement spending are the fundamental source of projected federal red ink. Those deficits and associated debt accumulation eventually threaten the U.S. economy with a sovereign debt crisis – hardly a pro-growth strategy – or the necessity of dramatically higher taxes – also not supportive of more rapid growth. Even worse, those same entitlement programs are failing financially and not providing the intended secure safety net.

Last July, the Trustees of the nation's major safety-net programs raised the annual alarm that America's entitlement state is going bankrupt – driving up deficits now and leaving

America's seniors vulnerable to severe benefit cuts in the future.<sup>16</sup> Controlling spending is more efficient than tax increases for addressing debt challenges – sensible entitlement reform therefore can be a part a pro-growth agenda, while assuring the financing of these programs for future generation.

Health care programs continue to be the largest driver of projected federal shortfalls. The Congressional Budget Office (CBO) estimates that federal spending on health care will reach \$1.1 trillion in 2016.<sup>17</sup> Any serious effort to promote economic growth will have to address the U.S. health care system.

In addition to the dollars, the Affordable Care Act (ACA) must be reversed to mitigate the law's negative economic impacts. Burdensome requirements forced upon employers and individuals, and poorly constructed revenue streams should be changed to reverse their downward pressure on economic growth.

#### *Impact on Businesses*

The ACA's extensive requirements are diverting time and productivity from the private sector, slowing economic growth. AAF estimates that on average, individuals who work for a company with 50-99 employees lose \$935 in wages annually due to ACA regulations, and employees of smaller businesses with 20-49 employees, lose \$827.50 annually. Further, the ACA's regulations are reducing small business wages by \$22.6 billion each year and as of September 2014 these regulations (as well as rising health insurance premiums) had already reduced the number of jobs by 350,000 across the country.<sup>18</sup>

#### *Employer Mandate and the 30-hour Work Week*

The employer mandate has resulted in serious problems for employers; forcing many to provide coverage or pay hefty penalties and the mandate has stalled an already damaged economy.<sup>19</sup> Under the ACA's mandate, businesses that employ a worker for more than 30 hours a week must provide health insurance for that employee. In order to avoid the cost of the employer mandate penalty, employee hours would have to be reduced below the 30 hours per week threshold. According to AAF estimates in September of 2014, an employee earning the national average of \$24.31 an hour would see a reduction in wages of \$13,370 annually if their hours were cut below the 30-hour ACA standard. As illustrated in this example, defining full time employment as a 30-hour work week does not benefit the individual or the employer.<sup>20</sup>

Along with the potential for decreases in the number of full-time employees (and therefore wages), the ACA not only punishes employers for not providing coverage, but also for offering health insurance plans that are not up to ACA standard benefit requirements. The House has already moved to increase the workweek provision to 40 hours per week, and a

complete repeal of the employer mandate should be pursued, as it would lift some of the pressures on the economy.

*Poorly Designed Taxes*

Finally, building on the Protecting Americans from Tax Hikes Act of 2015, and provisions in the Omnibus Appropriations legislation,<sup>21</sup> we should finish the job of getting rid of two poorly designed taxes within the ACA could improve economic growth in the health insurance sector, and the innovative medical device industry. Both the health insurer tax (HIT) and the medical device tax should be fully repealed. The concept is a simple one, fewer burdens on industry allows for greater economic productivity.

The HIT, also known as the Health Insurance Annual Fee, was designed as a way to gain revenue from the newly generated profits for health insurance companies created by the employer and individual mandates. The HIT is assessed to insurers based on their share of total premiums paid; the total dollar amount to be collected across all insurers is set in statute and not actually based on profits. ACA provisions required the tax to collect \$8 billion in 2014, and \$11.3 billion in 2015 and 2016. According to previous AAF research, this additional tax will be passed along to consumers, resulting in a premium increase of \$60-\$160 per person in 2014 and \$90-\$215 in 2015.<sup>22</sup> While the HIT has been suspended for 2017, permanently repealing this tax on health insurance would prevent premium increases for millions of consumers and decrease health insurer payments to the federal government. More importantly this tax is poorly designed, and an excellent example of how not to structure taxes.

The medical device tax included in the ACA establishes a 2.3 percent sales tax on all medical devices.<sup>23</sup> The tax creates higher costs for innovative health care companies, many of whom have high initial capital investments. The tax is poorly designed because it is levied on each individual sale and not a company's net profit. This means companies that are still in the red with their investments must pay the tax on sales of their device, despite not having turned a profit. It also increases insurance premiums, since the most expensive devices are generally covered by insurance, or used for services covered by insurance.

The medical device tax has already cost the industry over \$900 million.<sup>24</sup> There is broad bipartisan support for repealing this tax, and it has already been suspended for 2016 and 2017. In order to create large benefits for this industry and to decrease costs for medical device consumers, Congress should fully repeal the medical device tax.

**Conclusion**

The United States' recent disappointing economic past threatens to become its future without a commitment to a pro-growth policy agenda. Within this Committee's purview are



policies that could open markets abroad, improve a broken tax code, and undo the damage done to the health care sector and the economy by the ACA. These policy prescriptions should bolster economic growth, which will strengthen the nation's precarious finances. More importantly, faster economic growth is essential to improving the standard of living for the next generation, a basic obligation that has always been fulfilled in the past.

<sup>1</sup> This section is drawn from

<https://www.uschamberfoundation.org/sites/default/files/The%20Growth%20Imperative.pdf>

<sup>2</sup> See <https://www.uschamberfoundation.org/sites/default/files/The%20Growth%20Imperative.pdf>

<sup>3</sup> <http://americanactionforum.org/research/does-compensation-lag-behind-productivity>

<sup>4</sup> <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/49892-Outlook2015.pdf>

<sup>5</sup> <https://ustr.gov/trade-agreements/free-trade-agreements>

<sup>6</sup> [https://www.wto.org/english/res\\_e/booksp\\_e/world\\_trade\\_report15\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/world_trade_report15_e.pdf)

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[http://www.trade.gov/mas/ian/build/groups/public/@tg\\_ian/documents/webcontent/tg\\_ian\\_005406.pdf](http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_005406.pdf)

<sup>8</sup> <http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS>

<sup>9</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/245085/TTIP\\_and\\_the\\_50\\_State\\_s\\_GovUK.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/245085/TTIP_and_the_50_State_s_GovUK.pdf)

<sup>10</sup> <https://ustr.gov/TISA>

<sup>11</sup> <http://americanactionforum.org/insights/ooops>

<sup>12</sup> <http://americanactionforum.org/research/economic-and-budgetary-consequences-of-pro-growth-tax-modernization>

<sup>13</sup> <http://waysandmeans.house.gov/brady-highlights-how-the-path-act-helps-american-taxpayers/>

<sup>14</sup> See: Feldstein, Martin, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act." *Journal of Political Economy*, June 1995, (103:3), pp 551-72; Carroll, Robert, Douglas Holtz-Eakin, Mark Rider and Harvey S. Rosen, "Income taxes and entrepreneurs' use of labor." *Journal of Labor Economics* 18(2) (2000):324-351; Prescott, Edward C., "Why do Americans Work So Much More Than Europeans." Federal Reserve Bank of Minneapolis July 2004; Skinner, Jonathan, and Eric Engen. "Taxation and Economic Growth." *National Tax Journal* 49.4 (1996): 617-42; Romer, Christina D., and David H. Romer, "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks." National Bureau of Economic Research NBER Working Paper No. 13264 July 2007 Web.<http://www.nber.org/papers/w13264>

<sup>15</sup> Altig, David, Alan J. Auerbach, Laurence J. Kotlikoff, Kent A. Smetters and Jan Walliser, "Simulating Fundamental Tax Reform in the United States." *American Economic Review*, Vol. 91, No. 3 (2001), pp. 574-595

<sup>16</sup> <http://americanactionforum.org/research/the-future-of-americas-entitlements-what-you-need-to-know-about-the-me1>

<sup>17</sup> <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-BudEconOutlook-3.pdf>

<sup>18</sup> [http://americanactionforum.org/uploads/files/research/Impact\\_of\\_ACA\\_on\\_Small\\_Business\\_PDF\\_Format.pdf](http://americanactionforum.org/uploads/files/research/Impact_of_ACA_on_Small_Business_PDF_Format.pdf)

<sup>19</sup> <http://americanactionforum.org/research/primer-employer-mandate>

<sup>20</sup> <http://americanactionforum.org/insights/the-problem-with-acas-30-hour-work-week>

<sup>21</sup> <http://waysandmeans.house.gov/wp-content/uploads/2015/12/Final-WM-Health-Extenders.pdf>

<sup>22</sup> <http://americanactionforum.org/videos/fox-news-speaks-with-douglas-holtz-eakin-on-the-impact-of-the-acas-health-i>

<sup>23</sup> <http://americanactionforum.org/research/primer-the-medical-device-tax>

<sup>24</sup> <http://thehill.com/policy/finance/215522-report-medical-device-tax-missing-revenue-mark>

Chairman BRADY. Mr. Hassett, you are recognized.

**STATEMENT OF KEVIN HASSETT, DIRECTOR OF ECONOMIC  
POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE**

Mr. HASSETT. Thank you, Chairman Brady, Ranking Member Levin. It is really an honor and a pleasure to be here. Like Mr. Holtz-Eakin, my testimony is really divided into three parts. We didn't coordinate on that ahead of time.

The first part looks at how the economy has been doing and how that relates to what the administration has forecast the economy would be doing. And I think that the lesson of the first section of my presentation is that the administration has overestimated growth repeatedly, on average, by about a percentage point even though they have been able to update each year their forecasts based on the misses that they made before because my chart presents their forecasts a year ahead of the growth that we actually observe. And so, clearly, there is something going on where they are not using the right model or not updating the model that they are using because they keep making the same kind of mistake over and over and over again. I add—and it is an important qualification in my testimony—that I don't think that is a partisan thing at all because there are a heck of a lot of economists who are doing the same thing, you know, from the left and from the right.

But the third chart in my presentation suggests that there is sort of a reason why this has been going on, and it is that we have had a financial crisis, as Ranking Member Levin's presentation suggested, that when President Obama came into office, it was a terrible, terrible time and financial markets were falling apart. And if you look at the Reinhart and Rogoff data that suggest, well, how would an economy do after a financial crisis, you can see that generally it does a lot worse than a typical recovery. And in my third chart, you can see that the U.S. is doing a lot worse than a typical recovery, but they are doing about as much worse as you typically see after a financial crisis. And so if you wanted a reason why we have not done better than we have, then you could say, well, it is because we have experienced exactly the same thing that for hundreds of years countries have experienced after a financial crisis.

If you read Reinhart and Rogoff, you will see that part of the reason why you get slow growth is policy errors, and so then it opens up the question is, are there policies that we could pursue right now so that we could start to do better? And that is where the second part of my testimony begins. And there I think that there is a lot of hope. And, again, I don't think of it as a partisan hope. I think it is a hope for everybody who believes in science and economics.

And I focus my presentation in the second part just on papers that in the last 3 years have come out in the American Economic Review. This is not a partisan place. It is like the gold standard of economic journals. And in there, there is this literature that is starting to find that tax policy has a much bigger effect than economists used to think, and this is looking at actually hard, time series evidence of how the economy moves up and down. And my presentation discusses why the scientists at top universities, including the Romers—Christina Romer was President Obama's

Chairman of the Council of Economic Advisers—that why they are finding this is really quite intuitive, that over time when the economy goes up and down, if the economy goes down, then members of the Ways and Means Committee historically have said: Gee, the economy went down. We have to do something about it. Maybe we should have a tax cut to try to get the economy out of this recession and/or a spending increase.

But what that means is that if we look back at history over time, then in bad times, we have tended to lower taxes. And so if you don't account for that, then you will find that taxes tend to be low when things are bad, and you could, you know, conclude that supply-side economics doesn't work. In fact, it goes the other way.

If you exclude those endogenous policies from your analysis, you tend to find really big positive effects of tax cuts, really big negative effects of tax hikes. And to put that in perspective, if President Obama's team had believed this latest literature and revised their year-ahead forecasts to account for the negative effects of the tax hikes that happened when we lifted the top marginal rate, then their forecasts would have just about nailed the GDP growth rather than missing it by a lot. And so I think that, yeah, that is the scale of the tax effect discussed in my testimony.

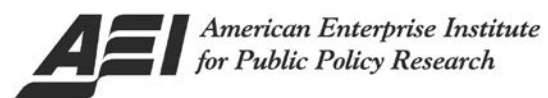
The third part of my testimony, which is less important maybe now for discussion, is that, you know, technical staffs will often say: Well, there is no economic model that can give you effects as big as what they are finding in the data, so the data must be wrong. And I talk about why there have been a lot of developments in the theoretical literature that suggests that we now understand why the economy responds as much as it does. And there, again, it is very, very intuitive. If you are a 35-year-old worker and we lift the tax rate, then if you work an hour less, then you lose the hour wage, but you also lose whatever increment to your human capital you would get from working harder. So you get some experience. You drive up your wage in the future, and if you don't work, then you lose not only the wage today, but the wage in the future. But if you are a person like myself, 54 years old, then if I, you know, don't work an hour, I am not really going to change my future wage very much. And so if you lift the top rate, what you ought to see is that younger people don't respond very much because they are worried about investing in their future by working harder today, and older people, like myself, will respond a lot to taxes. If you account for that effect and build it into models, you end up getting out of the models effects that are just about the size that we are seeing in the time series data.

And so, to conclude, what we are seeing now, I think, in the latest journals is almost a consensus emerging that taxes are having a much bigger effect on economies around the world than we thought. These results have been replicated in Canada, the U.S., the U.K., and Germany now. And so I think that what it suggests is that there is an enormous opportunity for this committee in the next few years to have a big positive effect on the growth of this economy.

Thank you very much.

Chairman BRADY. Thank you.

[The prepared statement of Mr. Hassett follows:]



Statement before the House Ways and Means Committee  
*Reaching America's Potential: Delivering Growth and Opportunity for All Americans*

Kevin A. Hassett

Director of Economic Policy Studies and State Farm James Q. Wilson Chair

American Enterprise Institute

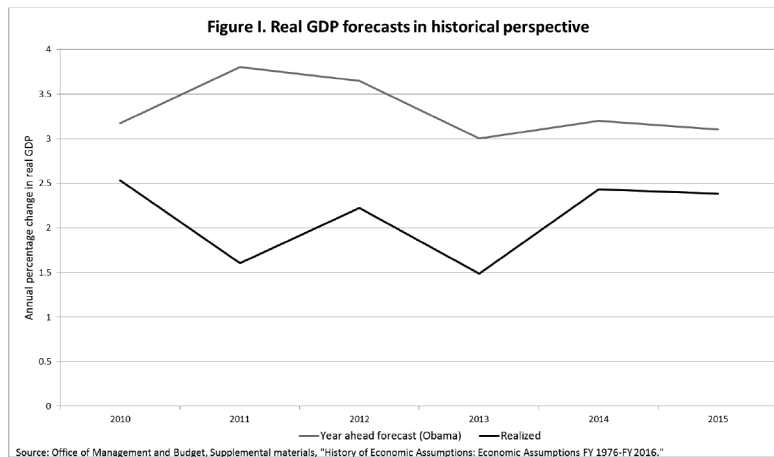
February 2, 2016

*The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.*

## I. Introduction

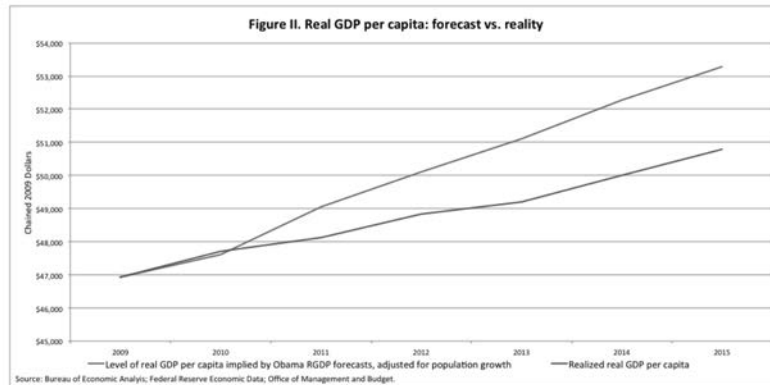
If any proposition generates a bipartisan consensus, perhaps it is that economic growth in the United States has been too low. We were reminded of this just last week when we learned that GDP increased at only 0.7 percent in 2015:Q4. As we review our economic experience, it is natural to ask whether such slow growth should be expected, and whether the disappointment might be related to policy actions that may have held the recovery back.

One simple way to evaluate this is to look at how real GDP performed, and to compare that to the outlook presented by professional forecasters. As can be seen in Figure 1, by this metric, the slow growth can be viewed as something of a surprise. The chart shows how real GDP growth has performed relative to the Obama Administration forecasts of real GDP growth generated during the year immediately preceding that year. (For instance, the real GDP annual growth rate forecast for the fiscal year 2010 was formed in February-May 2009, and was released with the budget for the fiscal year 2010. The value of the 2010 year-ahead forecast in Figure I is that forecast.) The pattern of underperformance is unambiguous.



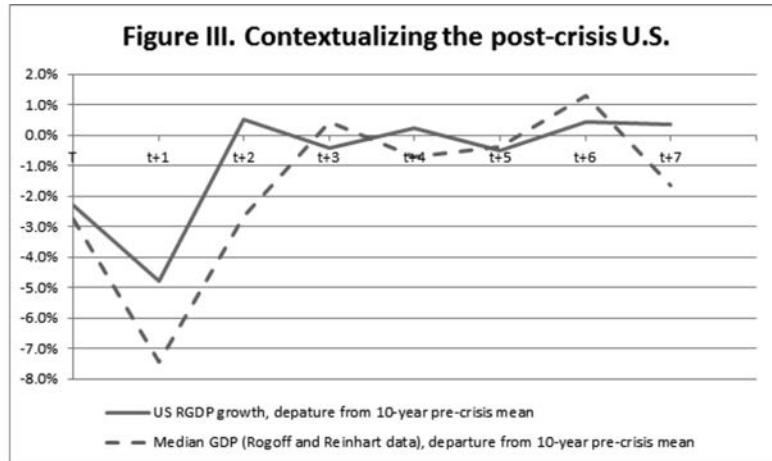
Another way of thinking about the situation is to assess how much higher real GDP per capita would be today, if real GDP per capita increased at the Obama Administration's year-ahead forecast of real GDP growth in every year since President Obama took office, adjusted for population growth. The first budget for which the Obama Administration provided growth forecasts was the fiscal year 2010 budget. If real GDP per capita, which was \$46,930 in 2009, then increased at the year-ahead real GDP growth forecast in every year between 2010 and 2015, after adjusting for realized population growth, real per capita GDP would have been \$53,293 in 2015. But the realized level of real per capita in GDP in 2015 was in fact only \$50,797. As

Figure II shows, this “forecast-implied” level of real GDP per capita in 2015 is \$2,496 (4.9%) higher than its realized value. To some extent, this captures well the stakes for economic policy.



I should add that such underperformance is not a unique characteristic of administration forecasts, and there is no reason to expect that the errors are in any way attributable to partisanship. Many private and independent forecasters made similar mistakes.

However, that does not mean that the slow growth should have been unexpected. Relative to other countries that experienced a financial crisis of their own—based on data that comes from Carmen Reinhart and Kenneth Rogoff, two Harvard experts on financial crises—the U.S. experience has been fairly typical. That is, as Figure III indicates, the U.S. growth path has been in line with what the history of recoveries from financial crisis would suggest it would be. For the most part, economies that have undergone a financial crisis go back to the “normal” they experienced before the crisis after an extended period of slow growth. We should be, if history is a guide, on track to return to normal. And Figure III suggests that we are.



To be sure, there are many other factors influencing growth besides the financial crisis. Regulatory and tax policy, in particular, will likely have to be adjusted if we are to experience growth on par with what the other countries that have fully recovered from a financial crisis have enjoyed. The good news is that the latest economic literature suggests that there is ample room for optimism if this committee pursues significant tax reform.

## II. The latest evidence on taxes and growth

For many years, the economic literature has been fairly divided regarding evidence that marginal tax rates have a significant impact on economic growth. But some areas of the literature remain less divided than others.

The literature suggesting that current corporate tax policy in the U.S. is quite harmful, and that lowering corporate taxes would likely increase growth, is one that is less divided. That is, the literature on the benefits that stand to be gained from lowering U.S. corporate taxes is less controversial than many corners of the literature on taxation. As I once told the Joint Economic Committee, for instance, there is substantial evidence that a “Laffer curve” exists for corporate taxation: the amount of economic activity generated by cuts to corporate taxes is so high that even if the rate of taxation decreased, government revenues from the corporate tax would increase, as economic activity came to the U.S. and became part of the U.S. tax base (Hassett 2012).

For the income tax, however, the estimates have been more mixed. There has, though, been a recent explosion in academic work that relies on a significant methodological innovation to better estimate tax effects. And this literature has strong implications both for understanding why growth in the U.S. has disappointed, and for understanding the likely growth path if marginal tax rates were reduced in the future.

Though this literature may seem technical, the innovation that sparked the recent explosion of academic work is quite easy to understand. The evidence it has generated, in fact, is so striking that it is essential that U.S. policymakers begin to incorporate it into their thinking. The basic problem for economists, the problem addressed by this innovation, is that policy tends to be set by policymakers with an eye toward how the economy is doing. For instance, if the economy is weak, a bipartisan consensus might emerge to cut taxes. But when a recession is out of mind and the economy is booming, it might be easier for policymakers to agree to raise taxes. This tendency would create a world where taxes might often be lower in bad economies not because taxes caused harm, but because tax cuts were introduced when stimulus was most needed. Economists can really only estimate the impact of something as complex as a tax cut if it were to happen exogenously—that is, if it were to happen as if by chance, without regard to the current state of the economy.

The innovation in the literature is to use narrative analysis to separate tax changes into those that were motivated by a weak economy, and those that were not, and then to estimate the impact of taxes using the latter, which are more likely to be exogenous and therefore informative as to the effects of tax changes. The literature is rapidly growing, and for brevity I will focus only on those papers in the *American Economic Review*, perhaps the leading economic journal.

The first study, the “inventor” of this methodological approach in some sense, was a 2010 study by David and Christine Romer of UC Berkeley (Romer and Romer 2010). They analyzed data from the U.S. and found that an income tax increase that raises revenues by 1% of GDP lowers output by 3% over three years. Karl Mertens of Cornell and Morten O. Ravn of University College London deployed a slightly different approach in a 2013 study also focused on the experience of the United States (Mertens and Ravn 2013). But, even using a different approach, they estimated effects similar in magnitude to those in the original Romer and Romer (2010) study. Specifically, Mertens and Ravn (2013) found that a change in the personal tax rate that lowers tax revenues by 1% of GDP increases output by up to 2.5%. The similarity of this estimate to that in Romer and Romer (2010) should give one confidence in the robustness of their estimates. This approach, rigorous and well-grounded, has since been used to analyze the experiences of other countries. James Cloyne of the Bank of England turned to the experience of the United Kingdom, which serves as a great case study because it has many clearly-identifiable episodes of tax reforms (Cloyne 2013). The estimate in Cloyne (2013) of the effect of tax cuts on output is, again, similar to the estimates in Romer and Romer (2010): a 1 percent cut in taxes increases GDP by up to 2.5% over three years. Others have applied the approach to other countries, and found similarly striking results.

A simple example can illustrate the relevance of these findings for understanding the recent U.S. economic experience. The year-ahead forecasts for GDP growth by the Obama Administration erred on the optimistic side for 2013 and 2014 by about 1 percent per year. If the Obama Administration had taken the results from the previous paragraph seriously, and factored into their forecast the negative effects of the increase in the top marginal income tax rate implied by the literature, then they would have reduced their forecast significantly. In other words, the forecast error would have been negligible if they had simply accounted for the impact of the tax increase using this latest evidence.



### III. Theoretical underpinnings

One argument levied against the existence of these effects, even though they are now well-documented, is that it is difficult to reconcile such large effects of income tax changes with the idea that workers that have a job tend to work about the same amount each year. If they do not work much harder when tax rates are cut, the argument goes, then how can we possibly get much GDP out of tax cuts?

This argument falters once one factors in the results of the latest research. The key breakthrough came from Keane and Rogerson (2011). Fortunately, the results are once again quite intuitive. The idea is that the return to working is quite different depending on how old you are. If you are very young, then if you work an extra hour, you get paid an hour's wage, but you also gain experience that increases your wages for the rest of your career. For an older person like myself, if I work an extra hour today it probably does not influence my future wage very much. I personally feel comfortable putting it in the official record that my own human capital as I approach my mid-fifties feels like it is declining.

Accordingly, one might expect that a tax increase would not reduce the hours worked of younger workers very much, since the younger workers would factor in not only the lost hourly wage but the lost value of the extra experience. By contrast, one might expect to observe a big impact on the labor supply of older workers. And the output effects for these older workers might be large, since they have accumulated all of that experience. The analyses that argue that workers don't respond much to tax rates have not accounted for this difference, and Keane and Rogerson (2012) show that fairly large labor supply responses to taxes are visible once one accounts for this affect.

In collaboration with the Brigham Young University Macroeconomics and Computational Laboratory and professors from BYU and Montana State University at the Open Source Policy Center (OSPC) at AEI, we have developed a model that allowed us to run a simulation that is consistent with the empirical findings of the last section. DeBacker et. al. (2015) deploys the methodology pioneered by the OSPC and its collaborators, which incorporates bridges between a microsimulation and a general equilibrium over-lapping generations (OLG) model to generate dynamic estimates of the effect of tax policy.<sup>1</sup> Modeling the effects of an across-the-board 10% statutory cut to marginal tax rates, they estimate that such a reform would result in a contemporaneous GDP increase of 1.64%. Though the growth rate effects diminish as time goes on, it remains significant.

These estimates rely on larger labor supply responses as discussed, and also suggest that the recent tax hike would have caused significant economic harm. According to that framework, younger individuals are less responsive to changes in marginal tax rates because human capital accumulation increases are a larger share of the marginal benefit of working an extra hour. This suggests that the labor force participation of younger individuals would have dropped much less than the labor force participation of older individuals in response to the recent marginal tax rate increases. If one looks at the changes in labor force participation between December 2012, the last month before rate hikes took effect, and October 2015, the data reveal precisely the pattern

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<sup>1</sup> The microsimulation is based on a rich set of realistic demographic characteristics, constructed by matching data from the IRS Public Use Files to data from the Current Population Survey.

across the age distribution that one would expect to observe under this view. Whereas labor force participation decreased by over 2% in the 55+ age group during this time period, it decreased by less than .5% in the 35 to 44 year old age group. In the 45 to 54 category, the decrease is just north of .5%.

Thus, evidence of the positive potential effects of tax reform appears to be robust in the data. The effects are consistent with results drawn from cutting edge models of the economy when we account for the different responses of workers at different stages of the life cycle. Recent forecasts of the economy by the administration have missed by about the amount one would expect if they underestimated the effects of recent tax hikes, and the labor force participation data have precisely the age pattern our discussion predicts.

#### IV. Conclusion and looking ahead

While literatures evolve, and there are always uncertainties, the level of confidence that members of this committee should have about the growth possibilities of tax reform is very high indeed. I would like to close by mentioning collaborative work we have been engaging in at AEI that we hope will help the members of this committee in its deliberations. AEI's Open Source Policy Center has developed a fully transparent suite of economic models for studying taxes. You shouldn't have to wait for weeks or months or years to learn about the effects of your proposals; you should be able to learn about the effects of your tax reform ideas as quickly as you think of them. Our new application allows anyone with a web browser to analyze individual and payroll tax changes under a variety of different growth and behavioral assumptions and to then receive a score, a dynamic score, and distributional tables at your desk. A wide range of assumptions concerning the impact of dynamic effects can, of course, be explored. As we look ahead to all of the positive possibilities of tax reform, our hope is that access to real time analysis of the ideas of every member of this committee will help stimulate debate and progress.

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Chairman BRADY. Mr. Bernstein, you are recognized.

**STATEMENT OF JARED BERNSTEIN, SENIOR FELLOW, CENTER  
ON BUDGET AND POLICY PRIORITIES**

Mr. BERNSTEIN. Well, thanks so much, Chairman Brady and Ranking Member Levin, for having the hearing today.

From the perspective of working families, probably the most important aspect of the current economy is the state of the job market. Here, the U.S. economy is on very solid ground. Payrolls were up \$2.7 million last year, slightly below the 2014 edition of 3.1 million jobs. The cumulative gain of 5.8 million jobs marks the strongest 2 years of payroll gains since the late 1990s. As was said, private businesses have now added 14.1 million jobs over 70—seven zero—straight months. That is a record consecutive streak. The unemployment rate is down by half since it peaked at 10 percent in late 2009.

These developments, along with very low inflation, are helping to boost real earnings of middle wage workers. After falling for 3 years, their real weekly earnings rose in both 2014 and 2015 by 1.8 percent and 1.4 respectively. In other words, while we can certainly find areas of concern in today's economy, there is too much inequality, too low productivity growth, we can and should grow faster than the average 2 percent real growth rate over this expansion. The labor market has been long improving, and if anything, job growth has recently accelerated.

Turning to tax policy, I stress two important criteria: making the Tax Code more effective at reducing rather than exacerbating pretax income and wealth inequality; ensuring ample revenues with respect to our fiscal obligations. Based on demographic pressures alone, we are going to need more, not less revenue going forward. One way to achieve these goals simultaneously, often with the added bonus of improving the economic efficiency of the Tax Code, is to eliminate or reduce tax subsidies and loopholes that contribute to wealth inequality, reduce investment, and incentivize the overseas outsourcing of American jobs.

In the spirit of these criteria, I would strongly urge the committee to be extremely wary of what are essentially trickle-down tax cut arguments. The evidence has not been friendly to such arguments. In my written testimony, I cite various nonpartisan experts. Here are some of their conclusions: Quote, "At the Federal level, there is virtually no evidence that broad-based corporate tax cuts have had a positive effect on growth. That has been amply demonstrated at the national level, where tax cuts have eroded revenue without discernible effect on economic activity."

Quote, "There is no evidence that links aggregate economic performance to capital gains rates."

There has been, quote, "no statistically significant correlation between capital gains rates and real growth in domestic GDP during the last 50 years."

Yes, there is significant room for improvement in our Tax Code, especially on the business side, but Congress must be wary of trickle-down tax cut fantasies. It would be nice if they were true, but they are not.

Turning to issues of poverty and inequality, we are going to hear a lot today about ideas to increase the economy's growth rate, but since economic inequality began to rise in the 1970s, middle class prosperity in the U.S. has not been a function of growth alone. As a much larger share of economic output has accumulated at the top of the income scale, less growth has reached the middle class and the poor. To the extent that low and middle income families have gotten ahead over these decades, it has been due to more hours of work at slower growing or even declining real hourly pay rates, increased government transfers, especially those associated work, like recently expanded earned income tax credits and the unique period of full employment in the late 1990s.

We cannot assume that overall GDP or productivity growth will yield opportunities for less advantaged families. Growth can't help them if it fails to reach them. I hope we can discuss policy ideas to reconnect growth and more broadly shared prosperity.

In this regard, the Affordable Care Act has been remarkably successful at reducing the economic insecurity associated with the lack of affordable health coverage as well as contributing to the slower growth of healthcare costs. Given the predominant role of healthcare spending in terms of our present and future fiscal outlook, the latter, slower growing healthcare costs, is essential in the pursuit of sustainable fiscal policy.

Despite heated rhetoric against it, there is just no way the ACA has killed jobs. I noted earlier the strength of overall employment since health reform came online, but my testimony digs into this claim that rules associated with healthcare reform have led to more involuntary part-time work. To the contrary, such work has been declining since the ACA went into effect, the same way it has in past recoveries before it existed.

Thank you. I look forward to your questions. And I actually yield back my time.

Chairman BRADY. Thank you very much.

[The prepared statement of Mr. Bernstein follows:]

**Testimony by Jared Bernstein, Center on Budget and Policy Priorities, 1/29/16**

Chairman Brady, ranking member Levin, I thank you for holding this important hearing on economic growth and opportunity.

While the range of issues I cover, including taxes, health care, trade policy, poverty, preparing for the next recession, and more, may seem disparate, there is, in fact, a strong unifying theme that links them. In every area, these are policies under this committee's purview that can help or hurt working families. My testimony will highlight a positive policy agenda by which Congress can support growth and help families facing challenges in today's economy.

Before I get to the specific policy areas, however, I begin with a brief overview of the current economic context within which these policy challenges are taking place.

**Current conditions**

The current US economy is characterized by very solid labor market trends, low unemployment, steady (if plodding) GDP growth, and unusually cheap energy.

*Energy:* Oil that sold for about \$100/barrel two years ago is now selling for around \$30. This sharp drop in energy prices has both reduced consumer prices and roiled global markets. From a macro-perspective, this price decline—a function of both increased supply of various energy sources and weakening global demand, particularly from China—is a significant problem for countries that are net exporters of this commodity and a potential advantage for net importers.

Though the US is still a net importer, President Obama meant it when he endorsed an “all of the above” approach to energy. The US has doubled its domestic oil production since 2008, as the shale boom has added 3 million barrels per day to the global energy market, while the administration continues to work to develop renewables. So, while we're still a net importer, more jobs, families and towns are now engaged in both the extraction of fossil fuels and the development of renewable energy. Thus, while price declines help American consumers broadly, and, by holding down inflation, boost real wage growth, some communities that have invested in energy extraction in recent years are hurt by oil's very low price.

*Jobs and Wages:* Job growth has been particularly strong. Net payroll gains in 2015 amounted to 2.7 million, slightly below the 2014 addition of 3.1 million jobs. That cumulative addition of 5.8 million jobs over the past two year marks the strongest two years of payroll gains since the late 1990s. Private businesses have now added 14.1 million jobs over 70 straight months, a record consecutive streak.

Figure 1 shows the components of real weekly earnings for middle-wage workers over the past few years: hourly wages, weekly hours, and inflation.<sup>1</sup> After falling for three years, real weekly earnings rose in both 2014 and 2015, by 1.8 percent and 1.4 percent, respectively, for these middle-wage earners. The figure also shows that while nominal wage growth has

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<sup>1</sup> The data are for the 82 percent of the private workforce that are blue-collar workers in manufacturing and non-managers in services.

slightly accelerated, the largest factor driving real earnings gains is lower inflation. While hourly wage growth picked up a bit last year, growing 2.4 percent in 2015 as opposed to the about 2 percent of the prior two years, the big difference was the sharp energy-induced decline in the price index.

Figure 1



[See end of document for figure sources.]

Though the actions of the Federal Reserve are beyond the purview of this committee, I note that even with their recent acceleration, recent wage gains are far from inflationary, a point underscored by recent inflation readings. Thus, from a monetary policy perspective, it is important that the Fed is cautious in its rate-raising campaign. The job market is clearly improving, and doing so at a faster clip than in recent years. But we are not yet at full employment, and I see no sign of a nascent inflationary threat. To the contrary, recent developments in the global economy may pose more of deflationary risk.

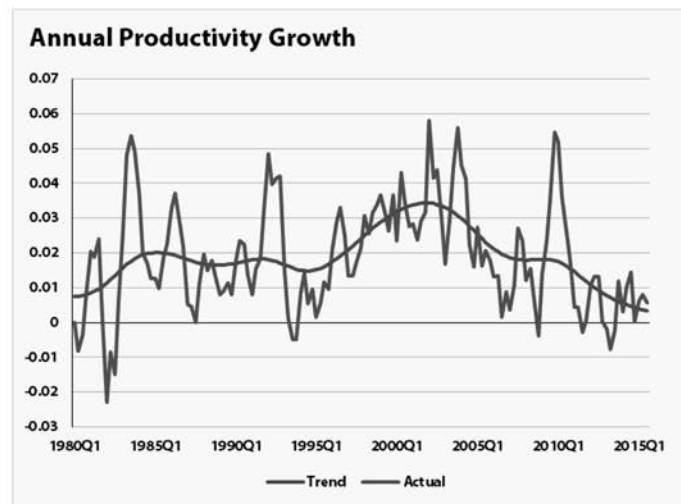
*Slow productivity growth:* There are two longer-term macroeconomic problems that I would bring to the committee's attention: slow productivity growth and our lack of preparedness for the next recession. I return to the second of these at the end of my testimony.

A key concern of today's hearing is the pace of real growth in the US economy, which has averaged about 2 percent since year-over-year real GDP growth turned positive in 2010. While that's about twice the growth rate of the Eurozone, it is moderate growth, held down by sluggish growth in productivity and a slower growing labor force. While part of the

slower labor force growth—maybe one-half to two-thirds—is an expected function of our aging workforce, the extent to which the growth of output per hour (productivity) has slowed deserves greater attention from policy makers.

Figure 2 shows yearly productivity growth along with a trend line that picks up the underlying movements of the series. Since 2010, trend productivity growth has been running at an annual rate of around 1 percent, well below its growth in the 1990s, when the trend accelerated from about 1.5 percent in 1995 to over 3 percent in 2000. Slower productivity growth is a bit like the weather: everyone complains about it but no one knows what to do about it. That said, in a recent analysis of the problem, I identified and reviewed three explanations: mismeasurement, capital misallocation, and persistently weak demand.<sup>2</sup>

Figure 2



While there's some evidence that increased measurement error is biasing productivity's growth rate down, measurement error is not a large factor, a point echoed in a recent [analysis](#) by Federal Reserve economists. Instead, there appears to be a significant role for capital misallocation. The opportunity cost of devoting an increasingly significant share of GDP to those parts of the finance sector that helped to inflate the housing bubble of the 2000s may be lower economy-wide productivity growth. That doesn't mean the level of investment is too low, though business investment as a share of GDP is not quite yet back to pre-recession levels. It means too much of our investment is non-productive.

Another source of slow productivity growth may well be the absence of full employment. Very tight labor markets lead firms facing higher labor costs to find efficiencies they

<sup>2</sup> <http://jaredbernsteinblog.com/the-productivity-slowdown-mismeasurement-or-misallocation-or-both/>



otherwise didn't need to maintain profits. As economist Larry Summers recently noted: "In a period of zero interest rates [corresponding to periods of weak demand] ... it is very easy to roll over loans. And therefore there is very little pressure to restructure inefficient or even zombie enterprises." In this sense, it is likely not a coincidence that the last period of strong productivity growth roughly corresponded with the full employment period of the late 1990s.

You will surely hear analysis that ties the productivity slowdown to the desired policy outcome of one advocate or another. It will be blamed on corporate taxes, "Obamacare," regulations, and whatever other boogymen partisans choose to invoke. I urge members to be skeptical of such facile causes. Taxation, health care reform, or regulation are particularly implausible targets, as they would presumably raise the cost of capital and slow productivity through a channel of diminished investment. But capital is extremely cheap and has been for some time, and firms are sitting on historically high levels of cash reserves.

Achieving full employment and more productive capital allocation are not quick fixes (though greater investment in public infrastructure is an example of smart, productivity-enhancing capital allocation, one I urge the committee to consider). While faster productivity growth is an essential goal of policy makers, beware of advocates trying to sell tax cuts and deregulation as the way to get there; their misguided thinking can be summed up by the old adage: "if your only tool is a hammer, everything looks like nail."

I now turn to the specific policy areas under the purview of this committee, with an emphasis on how public policy is supporting, or failing to support, growth and the well-being of American families.

### Health care

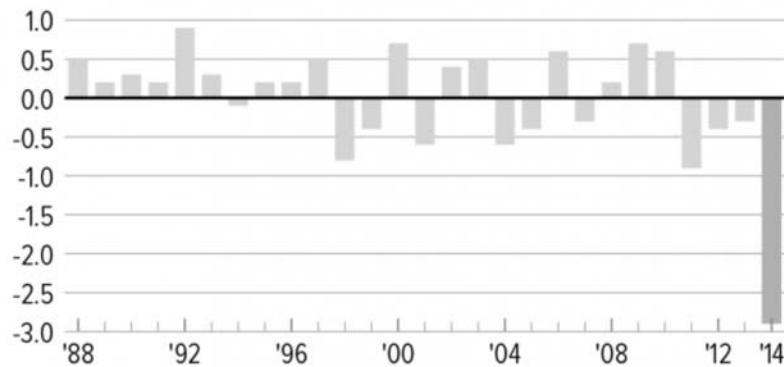
The Affordable Care Act has been remarkably successful: it has reduced the number of Americans without health coverage and contributed to the slower growth of health care costs. The former is a major advance in terms of reducing economic insecurity. Given the predominant role of health care spending in terms of our present and future fiscal outlook, the latter—slower-growing health care costs—is essential in the pursuit of sustainable fiscal policy.

*Coverage:* The number of uninsured people fell by 8.8 million and the uninsured rate declined by 2.9 percentage points in 2014, the year the Medicaid expansion and exchanges kicked in; as the graph below shows for the uninsured rate, these changes were by far the biggest single-year improvements on record. While coverage gains occurred in every state, the gains were greater in the 25 states (including DC) that adopted the Medicaid expansion by January 2014. The uninsured rate in expansion states is now 9.8 percent, while the uninsured rate in other states is 13.5 percent.

### Figure 3

## 2014 Drop in Uninsured Rate Biggest on Record

Change, in percentage points



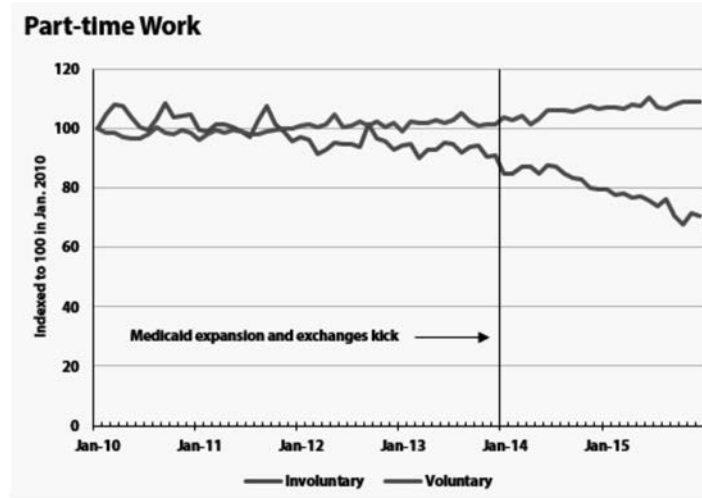
Source: CBPP analysis of Census Bureau, Current Population Survey data. Adjustments are made using Census Bureau guidance to account for survey design changes in 1999 and 2013.

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Some ACA critics maintain that these gains have come at the expense of job growth. This critique is hard to reconcile with the overall jobs numbers cited above, but what about more nuanced attacks? For example, because employer mandates, phased in over 2015-16, apply to firms with over 50 full-time workers, it is argued that the ACA is forcing people into part-time work. If so, we would expect to see an increase, relative to trend, of involuntary part-time work.

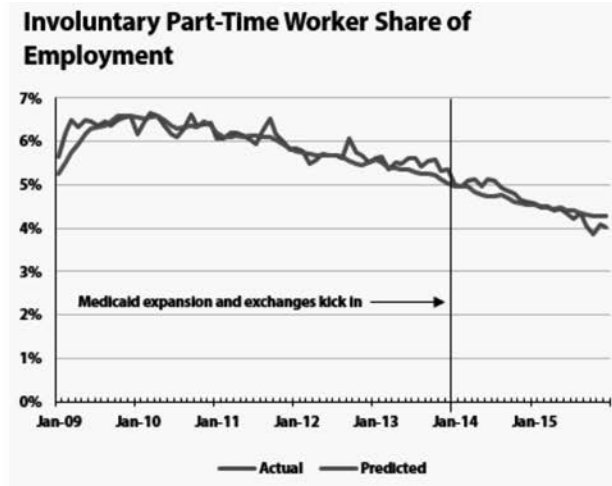
The next two figures show that's not happening. The first figure illustrates that involuntary part-time work has fallen; the decline appears to have accelerated since the ACA's exchanges and Medicaid expansion went into effect in 2014. Meanwhile, voluntary part-time work is up, perhaps, as economist Dean Baker has suggested, due to the ACA-induced release of "job-lock," where workers who would rather work part-time previously worked full-time in order to get employer-provided health benefits.

Figure 4



Of course, since we expect involuntary part-time (IPT) work to decline in a recovery, particularly one with solid job gains, a better assessment of the question of whether the ACA is leading to more IPT work requires a “counterfactual,” i.e., what trend we would expect had the ACA not been implemented. The next figure shows a predicted trend in IPT work (as a share of total employment) based on a simple model using the unemployment rate as a predictor. I ran the model using data through 2009 (pre-ACA passage) and predicted the trend in IPT work thereafter using actual values of the unemployment rate. The fact that the predicted trend hugs the actual trend suggests that IPT work is falling as it usually does in a recovery.

Figure 5



In other words, there is little, if any, evidence to support the claim that the ACA is a “job-killer.”

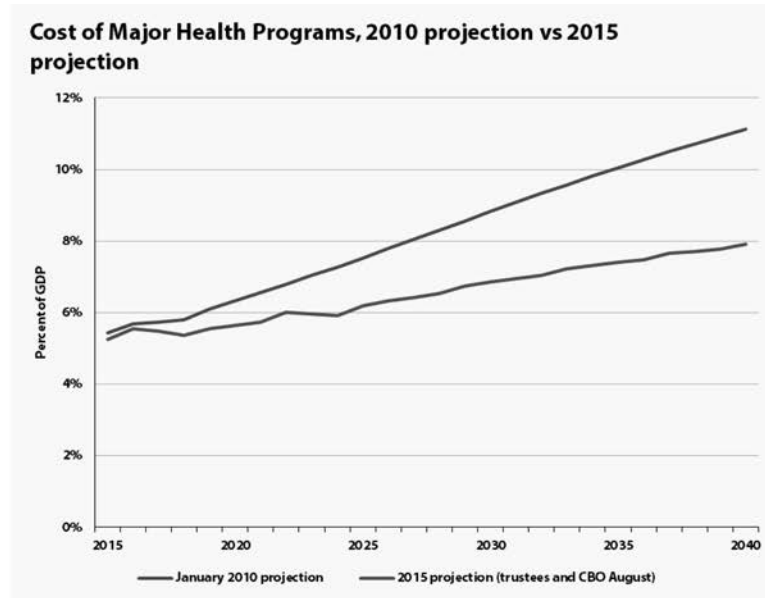
*Health care costs:* It is widely documented that health care costs have been growing more slowly in recent years. This trend is critically important, as cost pressures from the health sector—driven by both the aging of the population and the “excess cost burden”<sup>3</sup>—are a major contributor to our fiscal challenges. Projections of federal health spending are now substantially lower than they were in 2010, before the ACA was enacted.

Figure 6 provides more detail of these different projections. Each line represents CBO’s projected spending on major government health care programs as a share of GDP. The top line shows the 2010 projection of Medicare, Medicaid, and CHIP costs. The lower line, from CBO’s 2015 forecast,<sup>4</sup> includes the same programs as the earlier projection and also includes the ACA. Remarkably, total projected federal health care costs have shrunk substantially even though health care coverage has grown substantially. By 2023, the costs of these major health programs are down by 1% of GDP relative to the 2010 projection; by 2030 they are down 2% of GDP; and by 2038, by 3% of GDP.

**Figure 6**

<sup>3</sup> The excess cost burden refers to the historical trend of health care spending per capita growing faster than GDP per capita, leading health care spending to be an increasing share of GDP.

<sup>4</sup> This analysis uses CBO’s August baseline as opposed to their most recent one, which I did not have time to incorporate. The update would yield essentially the same picture, as the new CBO baseline reduces the gap between the two projections by just a tiny amount.



Health reform has reduced spending directly by scaling back excessive payments to Medicare providers. It has also accelerated the shift to new Medicare payment models that seek to reward quality of care rather than the volume of services. In addition, many analysts believe that health reform has indirectly encouraged structural changes in the health care payment and delivery system that will generate further savings. For example, interventions like “bundled payments” (an overall fee covering all the care related to a procedure), “accountable care” models (providers have monetary incentives to reduce spending below a set level while maintaining quality), and bonuses for reducing re-hospitalizations may be helping to slow cost growth. Other factors are surely behind these cost savings as well, as costs began to slow even before the new law was in place, but the ACA is having an undeniable impact.

### Trade<sup>5</sup>

Given this committee’s role in international trade and trade agreements, I wanted to note a few points and concerns regarding the Trans-Pacific Partnership, or TPP, from the perspective of economic growth and opportunity.

Contrary to simple textbook trade theory, the increase in international trade has not been an unequivocal good for all working families. In fact, more realistic theories of trade are quite clear on the point that trade creates winners and losers, with the latter typically including

<sup>5</sup> This section reflects my own views, and not those of CBPP, which does not take a position on trade policy.

those thrown into competition with cheaper workers abroad. Still, our highly productive workforce can compete globally, as long as the playing field is not tilted against them.

If the benefits of trade are to be more broadly shared, two things have to happen. First, our trade agreements must be more than handshakes between investors. They must provide workers from all signatory countries with the rights and protections they need to capture some of the benefits of trade. Second, we in the US must be able to lower our large and persistent trade deficits through enforceable rules against currency interventions that give our trading partners an unfair price advantage.

The TPP goes further than past agreements in various ways that could protect workers both here and in other signatory countries from unfair labor and wage practices. For example, the USTR worked out bilateral “consistency plans” with Vietnam, Malaysia, and Brunei that specify ways these countries must change their laws and practices to meet the general obligations in the TPP’s labor chapter. Of course, such provisions underscore the need for stepped up enforcement, an area where the US record has not been strong enough. A nonpartisan Government Accountability Office [survey](#) of this issue concluded that “monitoring and enforcement [of labor provisions in prior trade agreements] remain limited.”

An even greater concern is the absence of a consistency plan for Mexico, particularly because US auto production has been sharply increasing there. Mexican workers are typically unable to unionize or collectively bargain, and they make less than a fifth of what US autoworkers are paid. This combination of accelerated outsourcing of auto production to Mexico and suppression of workers’ rights there reduces living standards and increases inequality on both sides of the border.

Thus, in the spirit of trade that is both pro-growth and pro-worker, I urge this committee to carefully consider both enforcement and oversight provisions in the TPP, and the need for a plan to improve labor rights in Mexico.

On currency, the existing side agreement to the TPP has some positive features but no enforcement mechanism. As economist Joe Gagnon [points out](#), the “TPP partners merely reiterate the obligation they already have as members of the International Monetary Fund (IMF) to ‘avoid manipulating exchange rates ... to prevent effective balance of payments adjustment or to gain an unfair competitive advantage.’” The side agreement may well provide the information needed to quickly identify currency manipulators, but voluntary agreements only work if key actors, such as those at the US Treasury, take corrective action in the face of evidence. Unfortunately, our history here is lots of evidence and virtually no action. In the face of obvious currency management by China, for example, the US Treasury has been [extremely hesitant](#) to label them a currency manipulator.

The absence of a currency chapter in the TPP suggests the need for Congress to legislate enforceable currency rules outside of the trade agreement. For example, back in 2010, this chamber, while no less divided than it is today, overwhelmingly passed legislation that, if it had been enacted, would have allowed the Commerce Department to treat currency management as an unfair subsidy, calling for countervailing duties. Given the long history of

voluntary measures being inadequate to the task of pushing back on currency manipulation, such enforceable rules would be preferable to the voluntary approach.

Other aspects of the TPP also warrant close scrutiny. The fact that investors are using the investment dispute settlement procedure under NAFTA to challenge the administration's decision on the Keystone pipeline underscores the importance of making sure our sovereign rights are adequately protected. The agreement also has weaker rules of origin for automotive products than past trade agreements (e.g., NAFTA), which could hurt employment opportunities along our supply chains for cars and car parts.

### Tax Reform

Both Congress and the administration have argued for broad reforms in the tax code. From the perspective of economic growth and broadly shared opportunity, I would urge the committee to consider two important criteria when it comes to tax policy: making the tax code more effective at reducing, rather than exacerbating, pretax income and wealth inequality, and ensuring ample revenues with respect to fiscal obligations (based on [demographic pressures alone](#), we will need more, not less, revenues moving forward). One way to achieve these goals simultaneously, often with the added bonus of improving the economic efficiency of the tax code, is to eliminate or reduce tax subsidies and loopholes that contribute to wealth inequality, reduce investment, and incentivize the overseas outsourcing of American jobs. I specify numerous examples below.

In the spirit of these two criteria, I would also urge the committee to be extremely wary of what are essentially “trickle-down” tax cut arguments. Yes, our corporate tax code – with its internationally high statutory rate, much lower effective rate, and shrinking base – needs serious attention. But there is no basis for arguments that sharply reducing business or individual tax rates or not taxing foreign earnings will return large growth, job, and wage effects that will, in turn, lift the living standards of middle- and low-income families.

As tax expert Bill Gale (and colleagues), recently wrote, “At the federal level, there is virtually no evidence that broad-based [corporate] tax cuts have had a positive effect on growth... That has been amply demonstrated at the national level, where tax cuts have eroded revenue without discernable effect on economic activity.”<sup>6</sup>

While claims of tax cuts leading to large positive shifts in investment, productivity, and incomes are often heard in these hallways, in the real world, Gale's observations have been proved time and again. National expert Joel Slemrod has found that “there is no evidence that links aggregate economic performance to capital gains tax rates.” The non-partisan Tax Policy Center finds “no statistically significant correlation between capital gains rates and real growth in gross domestic product (GDP) during the last 50 years.”<sup>7</sup> Jane Gravelle, a tax analyst at the Congressional Research Service who has examined research purporting to show large gains from corporate tax cuts, points out that claims that “behavioral responses could cause revenues to rise if rates were cut do not hold up on either a theoretical basis or an empirical basis... Cross-country studies to provide direct evidence showing that the

<sup>6</sup> <http://assets1c.milkeninstitute.org/assets/Publication/MIRreview/PDF/05-12-MR68.pdf>

<sup>7</sup> <http://www.cbpp.org/research/presidents-capital-gains-tax-proposals-would-make-tax-code-more-efficient-and-fair>

burden of the corporate tax actually falls on labor [such that tax cuts will help workers] yield unreasonable results and prove to suffer from econometric flaws that also lead to a disappearance of the results when corrected...[C]laims that high U.S. tax rates will create problems for the United States in a global economy suffer from a misrepresentation of the U.S. tax rate compared to other countries...”

To be very clear, there is room for significant improvements in our tax code. Especially the business side of the code, as noted, is riddled with subsidies and loopholes that generate lots of work for tax lawyers and lobbyists figuring out new schemes for tax avoidance. In fact, the most recent CBO budget outlook predicts that “increasing erosion of the corporate tax base” due to “transfer pricing,” tax inversions, and other avoidance techniques will lower corporate income tax receipts by about five percent over the next decade.<sup>8</sup>

It is in attacking this sort of problem, as opposed to the pursuit of supply-side tax cuts, where I believe this committee could be most effective: cutting back or closing wasteful, costly subsidies and loopholes that exacerbate inequality, generate inefficiencies, and increase budget deficits.

--In a town where every tax break has someone to defend it, the *carried interest* loophole stands out as an exception: it is widely recognized by partisans on both sides of the aisle as providing an unfair tax break to a group that doesn’t need it. Investment fund managers get to pay the lower capital gains rate—about 24 percent as opposed to about the 40 percent they should pay—on a large part of their earnings generated by returns from the funds they manage. Note that these managers are not investing their own capital; the fund returns they get are thus a form of compensation. As such, they should be taxed like regular earnings. Ten year savings: \$15.6 billion over 10 years.

--In the spirit of economic growth, efficiency, and tax fairness, it would be extremely useful for Congress to “increase the bar” against *corporate tax inversions*. Though the US Treasury has attempted to reduce the incentives to invert through rule changes, the most recent example—the Johnson Controls/Tyco inversion—shows that more is needed.

It is well documented that these restructurings are not in the interest of uncovering economic efficiencies, but in the interest of tax avoidance. According to [news accounts](#), Johnson was already paying a relatively low effective tax rate of 19 percent, yet by merging with Tyco, headquartered in Ireland, it can lower its rate to 14 percent, a rate far below those seen in any plausible corporate tax reform plan floated in recent years. Instead of our companies figuring out ways to book more of their earnings in tax havens, we need them to focus on production, innovation, and job creation here in the US. Congress should thus make the inversion bar higher by requiring that historic shareholders of the US entity hold no more than 50 percent of the value of the newly formed company (as opposed to the 20 percent they must hold under current rules). If a merged company is managed, controlled, and has significant business activities in the US, it should be considered a US corporation for tax purposes. Finally, an “exit tax” could be another useful “speedbump” to discourage inversions.

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<sup>8</sup> <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51129-2016Outlook.pdf>



--Another loophole that partisans might be able to agree to close is the “*step-up basis*” provision by which the wealthy can pass capital gains on to their heirs tax free. When the unrealized gains of someone who dies are passed on to an heir, the appreciation is untaxed. President Obama has proposed to close this loophole, subject, as explained by tax experts Marr and Huang, “...to large exemptions to ensure that middle-income and even most upper-income people aren’t affected.” There is no good economic rationale for this loophole. To the contrary, it creates a tax incentive—a “lock-in” effect—to hold assets until death, even in cases in which realizing their appreciated value and investing those resources elsewhere might be more productive from an economic standpoint. The only score we have for the 10-year savings generated by closing this loophole includes the President’s proposal to raise the capital gains rate to 28 percent: \$233 billion.

--The President's FY 2016 budget proposes several other ways to reduce inefficient and wasteful loopholes around *estate taxes*. These include lowering the estate tax exemption threshold from \$5.43 million to \$3.5 million for individuals (\$10.86 million to \$7 million for couples), increasing the top rate from 40 percent to 45 percent, closing a loophole which allows an estate to put an investment in a trust to avoid paying capital gains (the Grantor Retained Annuity Trust loophole), and simplifying the tax exclusion rules for gifts to heirs. Under these changes, the estate tax would still affect only about 0.3 percent of decedents. Savings: \$153 billion.

--Instead of fighting over every one of the hundreds of *tax deductions and expenditures* in the tax code, limiting them to 28 percent instead of the top income tax rate of almost 40 percent would both improve efficiency (by ceasing to overly subsidize behaviors that would occur anyway, like saving for retirement or buying a home) and generate savings of \$525 billion over 10 years. Note that this cap on deductions does not end such deductions; it just reduces the disproportionate extent to which these tax benefits accrue to high income households.

--The fact that our tax code allows US multinationals to indefinitely *defer overseas earnings* provides greater incentives to book profits and create jobs abroad than here at home. Surely, this incentive pushes the wrong way in terms of creating opportunity for American workers. Moving to a territorial system would supercharge those incentives, threatening to hasten profit-shifting, offshoring and outsourcing. A better approach would be a minimum tax on foreign earnings – provided it was set at an adequate level – after which firms could repatriate their earnings without further taxation. Also, to reduce the incentives for deferral, Congress should consider prohibiting US multinationals from deducting interest expenses on loans that support overseas investments when they are deferring taxes on the profits generated by those investments.

These are but a few of the many loopholes and inefficient subsidies within our tax code. Addressing them would improve the code’s fairness and efficiency and boost revenues. In that regard, doing so should be regarded as a key part as a positive growth and opportunity agenda.

### **Poverty and inequality**

Since economic inequality began to rise in the 1970s, middle-class prosperity in the US has not been a function of growth alone. As a much larger share of economic output has accumulated at the top of the income scale, fewer pre-transfer resources have reached middle-class and poor families. As a result, poverty rates have become more “sticky”—less responsive to growth—and market incomes of the middle class have grown more slowly due to wage stagnation. To the extent that low- and middle-income families have gotten ahead over these years, it has been due to more hours of work at slower-growing or declining real hourly pay rates, increased government transfers (especially those associated with work, like the Earned Income Tax Credit, or EITC), and the unique period of full employment in the late 1990s.

These facts are particularly germane in the context of this hearing, as they link the two aspects of the themes at hand: growth and opportunity. Too often, it is assumed that overall GDP or productivity growth will yield opportunities for less advantaged families, but growth can’t help them if it fails to reach them. Here, then, are policy ideas I urge the committee to pursue to help achieve not just growth, but broadly shared growth.

--Areas I’ve discussed already, including *health care, trade, and tax reforms*, are germane here as well. By providing affordable coverage with subsidies for low- and middle-income families, the ACA helps to offset the dis-equalizing impacts of growth. Enforcing global labor rights and fair currency practices helps put our factory workers on a more level playing field. And closing loopholes like step-up basis and blocking corporate inversions will prevent the tax code from further exacerbating pretax inequalities in the distribution of market outcomes.

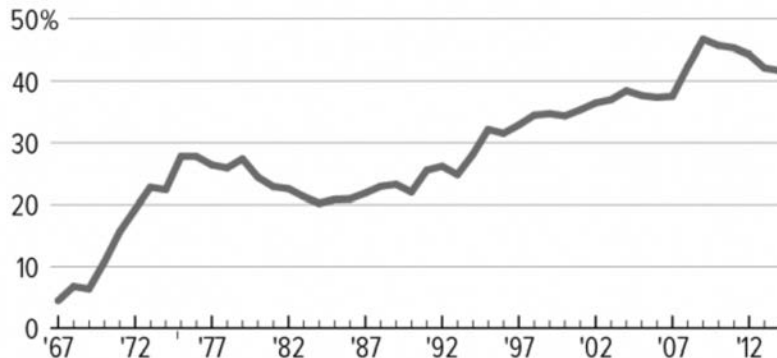
--This committee’s purview over many *safety net programs* underscores its essential role in anti-poverty policy. Moreover, House Speaker Paul Ryan’s recent discussions of poverty policy suggest that while strong differences remain between the parties in this area, there may be potential for some bipartisan actions.

Research at CBPP has highlighted two important facts regarding the impact of the safety net. First, when properly measured—when tax and noncash benefits are factored in—the anti-poverty effectiveness of the safety net has grown considerably over time. The figure below shows that in the late 1960s, anti-poverty measures lifted about 4 percent of the poor out of poverty. Now, they lift about 40 percent, a tenfold increase in the safety net’s anti-poverty effectiveness.

**Figure 7**

## Safety Net's Effectiveness at Reducing Poverty Has Grown Nearly Ten-Fold Since 1967

Percent of otherwise poor lifted above the poverty line by the safety net



Note: For each year, figures show the percent reduction in the number of people in poverty from when government benefits and taxes are not counted to when they are counted. Calculations use Supplemental Poverty Measure (SPM) and 2012 SPM poverty line adjusted for inflation.

Source: 1967-2012 data are from Christopher Wimer et al., "Trends in Poverty with an Anchored Supplemental Poverty Measure," Columbia Population Research Center, December 2013. (Plot points generously shared by the authors.) For 2013-2014, CBPP analysis of Census Bureau data from the March Current Population Survey and SPM public use files.

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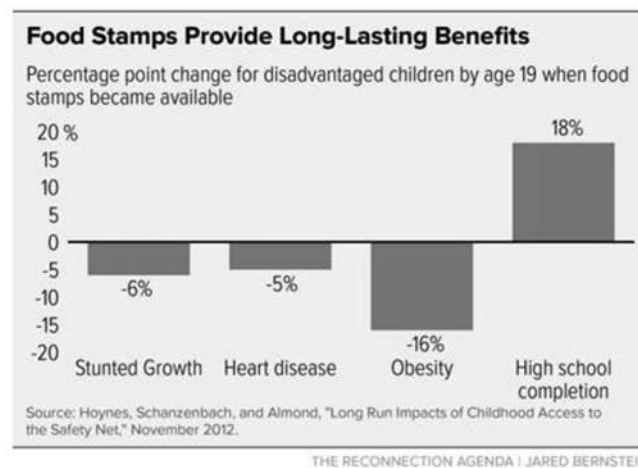
Unfortunately, one anti-poverty policy has become less effective over time at reducing hardship: Temporary Assistance to Needy Families, or TANF. TANF expert Donna Pavetti [has shown](#) that when welfare reform was passed in 1996, 68 percent of poor families with children received cash benefits from the program, compared to 23 percent today. Pavetti also points out that states devote only half of their TANF funds to basic assistance, child care, and work activities (only 8 percent goes to helping recipients prepare for work).

These shortcomings relate to the decision to remove TANF's individual entitlement to benefits by turning the program's funding into a block grant, thus undermining the program's ability to respond adequately to increased need. In the last recession, for example, many states' TANF programs responded inadequately or not at all to the large rise in unemployment, leaving large numbers of families in severe hardship. In 16 states, TANF caseloads rose by less than 10 percent between December 2007 and December 2009; in six states, caseloads actually fell. This performance contrasts sharply with SNAP (food stamps), a program where funding still expands in response to rising need. In fact, the number of SNAP participants rose by 45 percent during the period noted above.

These very different responses to increased need should be foremost in members' minds when considering Speaker Paul Ryan's "opportunity grants" idea—consolidating numerous programs, including SNAP, into a large block grant. This idea would likely increase poverty, not reduce it.

Second, while conservatives claim that anti-poverty measures keep people poor, longitudinal research that tracks children into adulthood has found that, to the contrary, the receipt of certain benefits acts more like a long-term investment than a simple boost to immediate consumption. For example, as the figure below shows, adults who received food stamps when they were children were 18 percent more likely to complete high school and 16 percent less likely to be obese than peers who did not benefit from nutritional assistance. As explained by poverty expert [Arloc Sherman](#), other [studies](#) show that EITC receipt "...increases the likelihood of children being born at a healthy birth weight, having higher reading and math test scores in school, being more likely to go on to college, and having higher earnings in adulthood."

Figure 8



Sherman also summarizes the mobility-enhancing benefits of "well-designed" rental assistance programs: "young children whose families were living in public housing and used rental vouchers to move to low-poverty neighborhoods fared better in various respects — such as earning 31 percent more by age 26 — than similar children whose families were not assigned vouchers under the demonstration project." These findings are particularly important for low-income African American and Hispanic children, as they are more likely to grow up in neighborhoods of extreme poverty that impinge on their economic mobility.

Policy changes that would diminish or underfund these safety net functions must thus be avoided, particularly as economic inequality and the absence of full employment labor markets mean that growth today is less likely to reach the poor.

--**Pro-work, anti-poverty tax credits:** Because it was not paid for, the bipartisan tax deal at the end of last year lowered expected revenue and thus increased the budget deficit. But by enshrining major improvements to two major anti-poverty tax credits—the EITC and Child Tax Credit (CTC)—into permanent law, Congress took an important step toward increasing the living standards and opportunities of working poor and near-poor families. These improvements included reducing the earnings threshold needed to qualify for even a partial CTC to \$3,000 (from \$14,600), increasing the threshold at which the EITC phases out for married filers (to \$5,000 above the threshold for single filers, up from \$3,000), and boosting the EITC for families with more than two children. Altogether, making these improvements permanent benefited 50 million people and raised around 16 million people out of poverty or closer to the poverty line in 2013; roughly half of the beneficiaries are children. As one example of the improvements' impact, a single mother of two working full time at the federal minimum wage will be able to earn a \$1,725 CTC; if these key provisions had been allowed to expire, she would have lost her entire benefit.

One other priority I urge the committee to consider is to boost the EITC for childless adults. Low-income, childless workers receive no credit if they're under 25 and a very small credit if they're 25 or older; as a result, they are the only group of people the federal government taxes into or deeper into poverty. Again, boosting the EITC for childless workers is a bipartisan idea: both Speaker Ryan and President Obama have issued nearly identical proposals to help fix this problem. Their plans would drop the eligibility age down to 21, increase the credit's phase-in rate, and raise the maximum credit to \$1,000.

--Periods of **full employment** have been relatively few and far between over the period when inequality has risen, a fact that is not at all a coincidence. Especially given the low rates of union membership in the US, the tautness of the job market is one of the main determinants of the bargaining power of middle- and low-wage workers. At very low unemployment, employers must bid up compensation to get and keep the workers they need, enforcing a more equitable distribution of productivity growth. These dynamics are particularly beneficial to the poor, who benefit disproportionately from full employment.

Public policies that would help promote full employment, outside of those of the Federal Reserve, include reducing the trade deficit (and thus minding the currency issues raised above), investment in public infrastructure, better oversight of financial markets (to prevent the inflation of recession-inducing bubbles) and, particularly for the poor stuck in "job deserts," direct job creation.

Policy changes that would reduce or underfund these safety net functions must thus be avoided, particularly as economic inequality and the absence of full employment labor markets mean that growth today is less likely to reach the poor.

#### **Getting ready for the next recession**

Though global markets have been roiled by the sharp fall in oil prices and the slowing of growth in emerging economies, particularly China, the US economy continues to generate steady growth rates and strong job growth. That said, there is another recession out there somewhere—economists cannot reliably predict when it will hit—and given the broad

purview of this committee, it is worthwhile to examine the condition of the nation's countercyclical policies.

The first point to make here is that, contrary to oft-repeated prejudices driven more by anti-government ideology than fact, the full spate of countercyclical interventions aimed at the last recession were highly effective. A [recent review](#) by economists Alan Blinder and Mark Zandi finds that the combined impact of these interventions, including those of the federal government and the Federal Reserve, cumulatively saved about 10 million jobs between 2009 and 2012. Blinder and Zandi's analysis of the fiscal stimulus—the American Recovery and Reinvestment Act (ARRA) especially—is particularly germane. They estimate that temporary boosts in spending on SNAP (food stamps) and unemployment insurance benefits had the largest “bang for the buck” of any of the fiscal stimulus provisions; for example, they estimate that every \$1 spending increase on SNAP generated a \$1.74 boost to the economy in the first quarter of 2009. According to their model, ARRA had increased economic growth by 3.3 percent and added 2.6 million jobs at the height of its impact in 2010.

With those lessons/findings in mind, consider that the US economy faces two related challenges regarding the next recession. One challenge is technical: the “zero lower bound,” or ZLB, which is the risk that the Federal Reserve's main tool against recession—the interest rate it controls—could be quite low by the time the next recession hits. This rate will have little room to fall, and thus little room to provide much in the way of monetary stimulus.

The ZLB elevates the importance of a countercyclical fiscal policy response, which brings me to the second challenge, a political one. Namely, policy makers must recognize the following principles:

**--Budget deficits should expand in recessions and contract in expansions.** In fact, they have done so since the so-called Great Recession, as the deficit topped out at about 10 percent of GDP in FY 2009 and was most recently found by CBO to be 2.5 percent of GDP in FY 2015. It is also important to remember that it is not temporary spending measures that drive deficits over the long term. It is permanent measures (spending increases *as well as tax cuts*) that are not paid for. “Austerity” measures—fiscal contraction in weak economies—have been shown to be harmful to growth, jobs, wages, and incomes both here in the US and even more so in Europe.

**--Countercyclical programs should trigger on in a timely manner and not trigger off too soon.** Unemployment insurance (UI), state fiscal relief, increased nutritional benefits, housing vouchers, and direct job creation were all helpful in generating the Blinder/Zandi results just noted. But the stimulus from many of these programs relied on legislation from Congress; it would be better to make these programs more automatically responsive to future recessions. Doing so won't obviate the need for Congress to act when hard times hit, but it will help to ensure that stimulus “triggers on” in a more timely fashion, that it is calibrated to need, and that it lasts for an appropriate period of time. Ben Spielberg and I will shortly release an analysis of these dynamics which includes ideas to improve the responsiveness of the countercyclical programs mentioned above.

*--State-level finances for the UI system should be improved.* Given this committee's role in maintaining a strong and responsive UI system, there are serious concerns about developments in some states in recent years. Some states have restricted UI by reducing the basic number of weeks available, cutting benefit levels, and introducing more restrictive eligibility requirements. In addition, 34 state trust funds currently fail to meet DOL's minimum standard for being prepared for a recession.<sup>9</sup>

Part of the problem is that many states only tax a small share of worker wages and have not adjusted this level for many years. California, for example, taxes only the first \$7,000 of wages, the minimum required under federal law, and 17 other states also set their taxable wage base under \$10,000. In this regard, I urge the committee to consider an increase in the federal government's \$7,000 wage base, which serves as the minimum for states and has not been increased in over 30 years.

### Conclusion

The US economy has been growing steadily since the second half of 2009, payrolls have been on a solid growth path, and as the job market edges closer to full employment, nominal wage growth has slightly accelerated. These dynamics, along with unusually low-inflation, have led to real earnings gains for middle-wage workers in both of the past two years.

However, in our age of high levels of economic inequality, macroeconomic growth is necessary but not sufficient to raise middle incomes and lower poverty. In the testimony above, I have suggested a positive policy agenda in the areas of trade, tax reform, poverty, inequality, health care, and countercyclical policy that will help reconnect American families to overall growth. Taking steps to enforce rules against currency management, building on the successes of the ACA, passing a bipartisan expansion of the EITC for childless adults, closing inefficient and inequality-increasing tax loopholes, not falling prey to wasteful, "trickle-down" tax cuts, and ensuring our countercyclical policies are ready for the next recession are all ways this committee, with its encompassing purview, can help bring about this reconnection. I look forward to working with you to achieve these goals.

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<sup>9</sup> Defined as having an "Average High Cost Multiple" below 1.0. This number is as of the third quarter of 2015, the latest data is currently available. See [http://www.ows.doleta.gov/unemploy/content/data\\_stats/datasum15/DataSum\\_2015\\_3.pdf](http://www.ows.doleta.gov/unemploy/content/data_stats/datasum15/DataSum_2015_3.pdf).

## Sources for figures

- Figure 1: BLS
- Figure 2: BLS, with HP trend
- Figure 3: CBPP
- Figure 4: BLS
- Figure 5: BLS, my calculations
- Figure 6: CBPP
- Figure 7: CBPP
- Figure 8: CBPP





Chairman BRADY. Mr. Moore, you are recognized.

**STATEMENT OF STEPHEN MOORE, DISTINGUISHED VISITING FELLOW, INSTITUTE FOR ECONOMIC FREEDOM AND OPPORTUNITY, THE HERITAGE FOUNDATION**

Mr. MOORE. Mr. Chairman, thank you very much for the opportunity to testify.

Chairman BRADY. Can you grab that microphone, Mr. Moore?

Mr. MOORE. Thank you very much for the opportunity to testify today. I was thinking as I was just sitting in this grand room—I have been in this room, as many of us have, to testify—and I was thinking back about the mid-1980s, and 1985 to 1986 sitting in the same room, and I see some of the same people—Congressman Johnson, I know you were here then—and we achieved something really remarkable, extraordinary, something that hardly has ever happened in the last 30 or 40 years, one of the great bipartisan achievements of this institution. I am talking, of course, about the 1986 Tax Reform Act. And this was an act that, as you all know, was bipartisan. We reduced tax rates from 50 to 28 percent at the top, and we did that by broadening the base, and in a very economically efficient way. And I think almost all economists—I can't speak for Jared—but I think all economists agree that what we did in 1986 was what increased the efficiency of the American economy by reducing distortions in the tax system.

Now, the reason I mention this, Congressman, is that, many of you probably don't know this, but that bill was promoted by people like Bill Bradley, the Senator from New Jersey, a Democrat; Dick Gephardt, who was the minority leader among the Democrats was—I mean, the majority leader for the Democrats was one of the House sponsors of that bill; of course, Jack Kemp and others. And here is the amazing thing: A bill that lowered the highest income tax rate in the United States to 28 percent passed 97 to 3 in the United States Senate. Let me say that again: 97 to 3. When is the last time in the last 30 years we have seen anything like that kind of bipartisan consensus?

What I am suggesting is this is a plea to you, Mr. Levin, and to you, Mr. Brady, get together and get this done in a bipartisan way because the stakes are so huge. You have an opportunity, every single one of you on this committee has an opportunity to make history, and I hope you won't lose that opportunity. It has been 30 years. When you think about we did this in 1986, we haven't cleaned out the stables of the tax system in three decades. It is high time we do that.

Let me talk a little bit, then, about the economy. First, this is a really, really weak recovery. And you don't have to—it sort of reminds me of the old Groucho Marx line, "Who are you going to believe, me or your own two eyes?" I mean, we can present as many statistics as you possibly need about this recession, but you know the people who know that this is a flimsy, anemic recovery? The American people. And all you have to do is look at the people who voted in Iowa yesterday. Exit polls showed very clearly, what is their single biggest concern? The economy and jobs. The American people just aren't feeling love for this recovery that the President keeps trumpeting as some kind of grand success. People are nerv-

ous. People think the American dream is gone, and that is the economic reality that every American is dealing with today.

So what is the problem? Well, if you look—if you don't mind turning to my testimony and looking at chart 1, if you have that in front of you, you can see the big problem is that we have had a recovery that is way, way, way behind trend. Now, it is absolutely true that Barack Obama inherited a terrible economy, but if you look at the Reagan recovery versus the Obama recovery, and I like to—I like this comparison because both these Presidents entered office during a period of great economic crisis. I can never understand, by the way, why people didn't say that what Ronald Reagan inherited in 1980, 1981 and 1982 wasn't a financial crisis. My goodness, the stock market over the previous 14 years had lost 60 percent of its value; we had 14 percent inflation, 20 percent mortgage interest rates. I would submit to you folks that that is a financial crisis par excellence.

And, basically, Reagan did use tax rate reductions, whatever you want to call it, supply-side economics, but we got \$3 trillion more growth over this period. That is a big number.

What I am saying is we would have \$3 trillion more GDP today if we had a Reagan-style expansion rather than an Obama recovery. That is a huge number.

Jared talks about income inequality. If we could just pass that money out, that extra \$3 trillion, and pass it to every family, that means every family in America would have \$15,000 more income. The average family doesn't have \$15,000 more income since Barack Obama came into office. The average family has about a thousand dollars less income.

Now, if you will look—I am going to skip chart 2, and I just want to mention this issue about the recovery. This has been—if you look at the Economic Recovery Act that we passed in the stimulus bill, what is amazing about chart 3 is not only did it not work, but if you compare what was supposed to happen—these are the White House's numbers, not my numbers—what it shows is not only did we have higher unemployment than we would have had if we would have had the—in other words, what this is saying is the unemployment rate today and the unemployment rate over this 4-year period is higher than even the Obama people said if we had done nothing. We would have more jobs today if we had not done the economic stimulus than we did. Government spending is not a stimulus. What is a stimulus is tax reduction.

What I say in my testimony—and I will end on this—is I believe the economy is very weak right now. I think we need an anti-recession insurance policy, and the best way to do this is you should vote in the next weeks ahead to cut the corporate tax rate now as a kind of down payment on tax reform later. That will create jobs and that will bring those businesses that are leaving back to the United States.

Chairman BRADY. Thank you, Mr. Moore.

[The prepared statement of Mr. Moore follows:]

Testimony

Stephen Moore

Visiting Fellow in Economics

Heritage Foundation

February 2, 2016

On

Tax Policy and Economic Growth

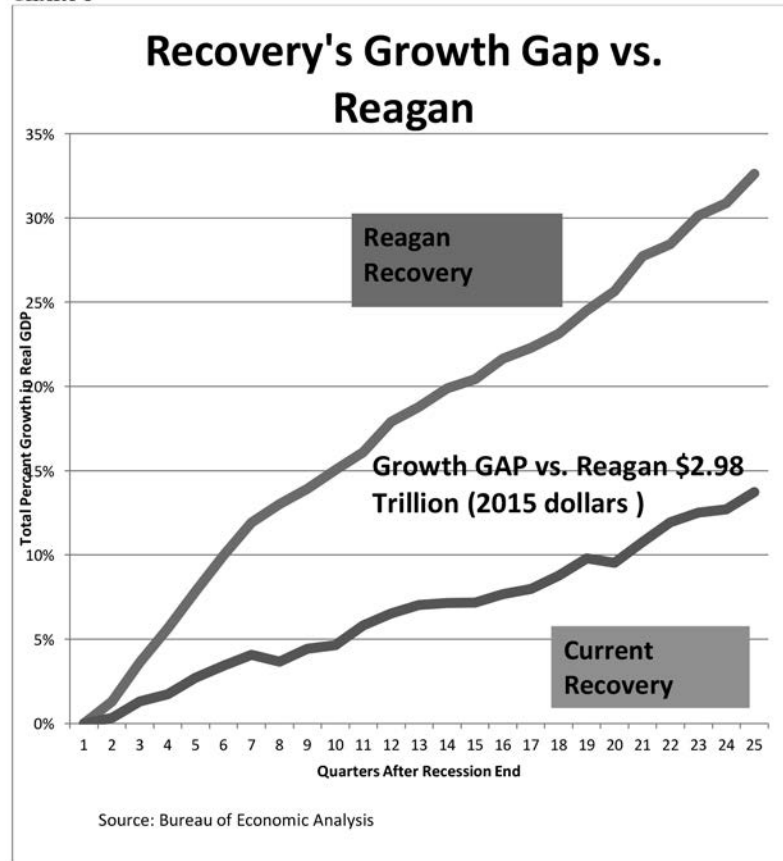
Mr. Chairman.

Thank you for the opportunity to testify before the House Ways and Means Committee on tax policy and economic growth. My name is Stephen Moore and I am an economist at the Heritage Foundation. Neither I nor the Heritage Foundation receive any federal funding.

The timing could not be more propitious for this hearing.

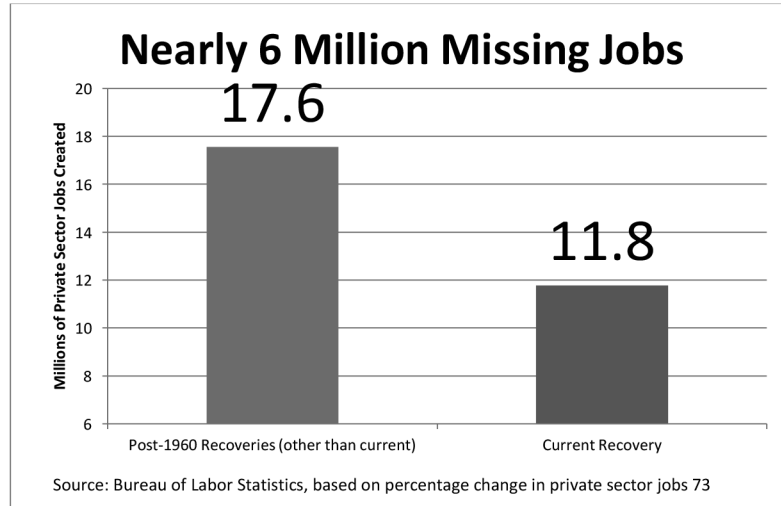
Last week the Commerce Department reported that the 4th Quarter gross domestic product grew by a minuscule 0.7 percent. This disappointing number is significant because now officially the growth gap between the Reagan recovery and the Obama recovery is just under \$3 trillion. In other words, if the economy had grown as fast under Obama since the recovery began than it did under Reagan's recovery, we would have \$3 trillion more output over the last 12 months. See chart 1.

CHART 1



We would also have 5 to 6 million more jobs. See chart 2. The jobs lost from anemic growth are roughly the size of the entire labor force of Ohio.

CHART 2



I would argue that the major reason that American workers are so angry and anxiety-ridden, and the reason that so many Americans are doubtful that the American dream is not going to be achievable for their children is that wages and salaries - or what Reagan used to call "real take home pay" - has been flat and even slightly negative now for a decade. Official Census Bureau figures show that since Obama took office seven years ago, the real median household income is DOWN by \$1,300. For over half of Americans, this is no recovery at all and a recession that never ended.

Now we are seeing that 2016 is off to a miserable start and it's hard to see much improvement in GDP in the first quarter. I've long argued that America is stuck in a 2 percent growth rut, but now the danger is we are falling below that anemic rate and there is even some chatter about a potential recession this year. At 2 percent growth the economy doesn't spin off enough jobs to increase wages, and tax revenues grow much too slowly to balance the budget.

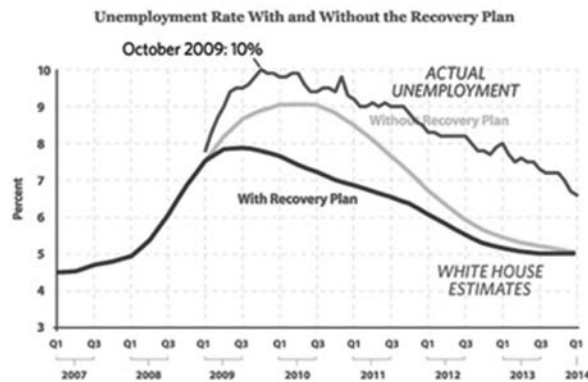
So the economy needs growth steroids and where should they come from?

Let's start with what we must not do. The 2009 Keynesian economic stimulus plan that cost \$830 billion may go down in history as one of the costliest public policy mistakes of all time. The evidence is now nearly irrefutable that the Obama spend and borrow policy with promised Keynesian "multiplier effects" gave us the slowest recovery from a recession in 50 years. Given how far the economy fell in 2008-09 when the real estate bubble popped, we should have had faster growth than normal during a rapid catch-up phase. That never happened and the vaunted "summer of recovery" that Vice President Joe Biden kept promising hasn't happened now for six summers.

The best evidence of the complete failure of the Obama stimulus comes from comparing the Obama administration itself. In early 2009 the White House economics team published a report showing what

unemployment would be without the stimulus plan and with the stimulus spending. Not only was unemployment much higher than the White House predicted it would be with the gusher of spending, it also turned out to be higher than it would have been had we done nothing! See Chart 3.

CHART 3



Source: "The Job Impact of the American Recovery and Reinvestment Plan," 2009, president's Council of Economic Advisers; Bureau of Labor Statistics, Labor Department. Graphic: The Heritage Foundation, April 2015.

Let me repeat: this is not my analysis, but that of the Obama administration itself. The White House's own claims when it sold Congress on the stimulus program shows the unemployment rate would have fallen faster and the economy more briskly had we not borrowed \$830 trillion. Now the Obama administration says that its own forecasts were wrong and that the economy turned out to be weaker than they thought.

But in my judgment what made the economy weaker than they thought was that almost every policy decision from 2008-2010 on economic and fiscal policy was exactly the wrong thing to do.

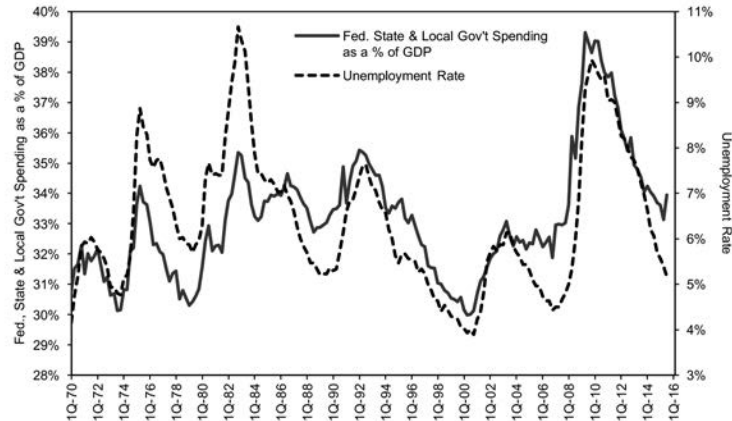
The reasons for our worst in modern times recovery can't all be blamed on the failed stimulus bill. Obamacare, the tax hikes on the rich, minimum wage increases, EPA regulations on our energy industry, and Dodd-Frank have slowed growth and hiring too.

One of the lessons that we have hopefully learned or relearned over the past decade is that government spending on food stamps and unemployment benefits, green energy subsidies for companies like Solyndra, and transit grants for rail projects to nowhere, is no way to improve growth in the short term and certainly not in the medium or long term. The Congressional Budget Office tells us that the long term effects of the stimulus plan are negative. In other words, we are a little poorer this year and every year going forward because of the massive borrowing. All we have to show for ourselves after the borrowing binge is massive debt repayments that will be made over decades. This didn't exactly help "the children."

What is done is done and if anything good can come of this fiasco, it is to learn the lessons of what went wrong and to never, ever make these mistakes again. Government borrowing and spending does not stimulate the economy. It never has as Chart 4, prepared by Arthur Laffer and I, shows.

CHART 4

**Government Spending as a Percentage of GDP vs. Unemployment Rate**



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Laffer Associates

I am not reflexively against borrowing during a time of emergency - nor should Congress be. It matters a lot what you buy with the debt. In the 1980s we bought a ferocious economic recovery and an end to the Cold War. It would be hard to argue that this borrowing didn't dramatically benefit future generations. In the 1990s under Bill Clinton we balanced the budget through growth of the economy and spending restraint, and that too was beneficial. Government spending fell from about 22 percent of GDP to below 19 percent during Clinton's presidency even as the economy boomed.

So since traditional Keynesian spending stimulus doesn't help, what CAN this Congress do to re-ignite American prosperity? I would recommend a short term and long term strategy. In a forthcoming report that I prepared for the Committee to Unleash Prosperity and Freedom Works, I recommend 12 steps to economic recovery. Although this report is not yet public, I will mention one here because the findings are so astonishing. We estimate that the value of oil and gas under federal lands that can be recovered with existing technologies like horizontal drilling and Fracking is at today's prices roughly \$50 trillion. This is arguably the greatest treasure chest in world history. Not only would we massively stimulate the economy by drilling on non-environmentally sensitive federal lands, while ensuring at least a half-decade of energy independence, but of special note to this committee, we estimate that over the next 20 years the government would raise \$3 trillion in revenues for Uncle Sam - at zero cost to taxpayers!

Someone please show me any other plausible plan that raises \$3 trillion over the next decade without wrecking the economy.



My colleagues Arthur Laffer, Larry Kudlow and I have recently recommended an immediate stimulus plan for the economy. We call this an insurance policy against recession. We 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 and perhaps a 5% voluntary repatriation tax on the \$2 trillion owned by U.S. multinational firms that is parked abroad to avoid the high corporate tax.

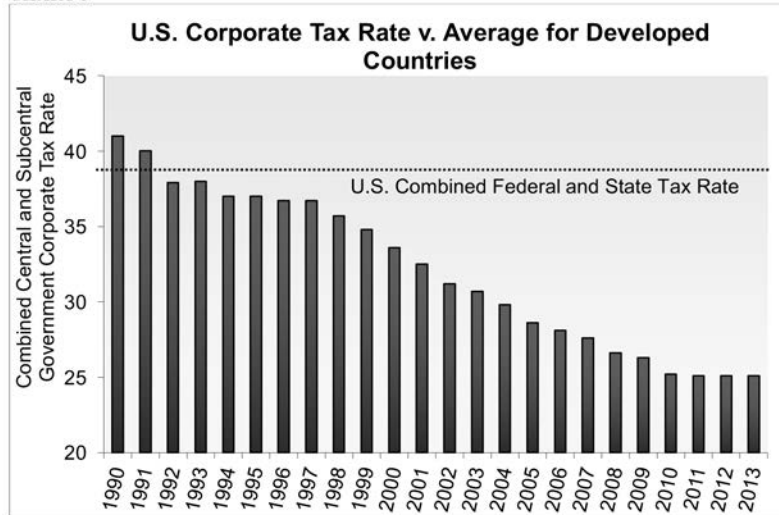
This won't cost the Treasury much in lost revenues, and who knows? It may raise money over five years through the money and businesses repatriated back to America. Apple and GE might bring back tens of billions of dollars for assembly plants and research centers on these shores.

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, Medtronic, 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 5. 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 5



Even President Obama's own tax reform commission, headed by former Fed chairman Paul Volcker found "deep flaws" in the corporate tax. It concluded that:

"The high statutory corporate tax rate reduces the return to investments and therefore discourages saving and investment...The tax acts to reduce the productivity of American businesses and American workers, increase the likelihood and cost of financial distress, and drain resources away from more valuable uses."

As for the stimulus value of our proposed business tax cut, the Tax Foundation finds that immediate expensing and cutting the business tax rate are the best short-term strategy for generating more growth. Here is how the Foundation put it: "A cut in the corporate tax rate would have large effects on GDP, but minimal effects on federal revenue in the long run." Nothing else has this kind of big bang for the buck payoff. By the way, for those Keynesians out there stuck on the demand side, tax rebates and credits produce almost no positive feedback.

Over the longer term, the ideal tax reform is some form of a flat tax. Make the base broad and get rates down as low as possible. The Tax Foundation finds that a tax reform that would cut tax rates to about 15 percent, as Senators Rand Paul and Ted Cruz have recommended, would increase economic growth by almost 10 percent over a decade. The growth derives from lower tax rates and the economic efficiency that derives from this policy change and by reducing taxes on capital investment and savings.

We have found in our polling at Heritage that what Americans want most from a revamped tax system is "fairness." Loopholes, special interest favors and carve outs from the tax base are inexcusable and bad

economics. By the way, in the tax bill that passed late last year, Congress extended the solar energy credits so that solar power companies can make money even though they produce losses. This credit was immediately capitalized into the value of companies like Solar City so in a sense, the Congress wrote a check to the shareholders of this company. Is there a more egregious example of corporate welfare in modern times?

Tax reform requires a cut in the capital gains tax. Some economists have suggested that capital gains tax rates have little impact on growth and only lead to a tax cut for the rich. However, in a forthcoming study by myself and my Heritage colleague Joel Griffith, which may be the most definitive economic history of the capital gains tax, we come to a different conclusion. We find that throughout most of the last 50 years, lowering the capital gains tax is associated with more federal revenues and higher rates are associated with less revenues. This is because the capital gains tax is a voluntary tax. Investors can avoid paying the tax by holding on to stock or other assets, which is called the "lock in effect." Investment in venture capital, and technology firms, and overall business investment, are all positively associated with lower rates of capital gains tax. The Clinton capital gains tax cut from 28 to 20 percent had very sudden and dramatic effects on business investment and revenues grew much faster than expected by the Congressional Budget Office when the tax cut occurred.

It is worth mentioning that business investment has been lagging in recent years as the capital gains tax has been raised by 60 percent, from 15 percent to 23.8 percent. In the latest 4th quarter GDP report, business investment was negative.

In sum, Congress should get ahead of a potentially painful slowdown in the economy in 2016 by passing a REAL stimulus plan - and that is a corporate tax cut. This will bring money home to the U.S. with little if any revenue loss. Congress should never believe in the false gold of Keynesian demand side stimulus plans and "shovel ready jobs." On net, they never materialized.

Finally, Mr. Brady, I am very excited about your chairmanship of this committee. 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. It passed 97 - 3 in the United States Senate. That miracle can happen again with your leadership and vision and we at Heritage wish to help you every step of the way.



Chairman BRADY. I think it is well-known our committee is pursuing a pro-growth Tax Code that is built for growth, built for the growth of families' paychecks and for the growth of our local businesses, for the growth of the U.S. economy.

Dr. Hassett, you explained, you know, these recent innovations in economic research that helps us see better about the impact of taxes on growth. And in the testimony, you state: When properly estimated, a 1-percent cut in taxes' share of the economy increases the economy by up to 2.5 percent over 3 years, so in the fairly short term. The opposite is true as well. In laymen's terms, can you explain a little, just a little about what this new clarity, what creates that?

Mr. HASSETT. Sure. I will give it another shot, try it in a slightly different way, that one of the things economists have learned in the last couple of decades is that if you want to evaluate a policy, the best way to do it is to have a random trial, right? So we apply policies to these folks but not to those folks, and we see what happens. If we design the trial well, we can learn.

The problem with tax policy and how it affects the economy is you don't get random trials. What happens is that, you know, governments around the world change tax policy up and down in response to how the economy is doing, but every now and then, they will change tax policy because of some exogenous factor. And so what people have done is historians, like Christina Romer, perhaps the greatest economic historian alive, dug through all the tax bills and looked at the bills that were passed for exogenous reasons, so you could think of it as kind of like a random trial, or for endogenous reasons, like we are in a recession right now, so we need to do something. And then they looked at the effect of the exogenous ones, which are a true random experiment, and they tend to find really, really big effects of taxes. And this, again, is an experiment that has been repeated over and over. It is in the very, very top journals, the American Economic Review, the Quarterly Journal of Economics. It is Democrats and Republicans doing that kind of science and finding these big effects.

And so to say that there is no evidence of these big effects is just—it is just false. There is a lot of evidence.

And, you know, you cited Bill Gale's paper on this. I was his discussant at a Brookings conference, and I don't know if there are members of the audience who were there, but I think that they are probably going to have to revise that paper after the discussion. The fact is that there is really exciting literature going on that makes sense, and, again, that is the part where I start to peel it back. So we have got models that say that we should get an effect that that is big and that we should if—when we hike the tax rate like we just did, if the labor force participation for people late in their working lives goes down, which is exactly what we saw happen. And so things are really starting to add up and to line up.

And so what that means, I think, is that people of this committee should recognize that they have a great responsibility because if you do the right things, you could really have a big positive effect on growth.

Chairman BRADY. And those tax cuts were for productivity, incentivize productivity, the labor force. That is key.

Mr. Moore, in your testimony, you talk a lot about how more and more American companies are being acquired by foreign companies because of our so anticompetitive tax system. Just first, it seems like every week, we are seeing a major announcement, including a local company that is headquartered maybe 2 miles from my own home. And so can you talk about what are the consequences of so—to American workers and to the American economy of so many companies leaving, and what is the urgency for Congress to act now to stem that tide and actually incentivize U.S. companies to remain and grow and invest here in the U.S.?

Mr. MOORE. So if you look, Mr. Chairman and Members of the Committee, to my chart 5 of my testimony, I think this is highly instructive. What this is showing you is the black dotted line is the U.S. corporate tax rate, Mr. Chairman, over the last 30 years. As you can see, we haven't changed it. It has been flat. Look at the red pillars. That is the average of all of the countries that we compete with. I think this is something like the 30 major OECD countries. And look at what is happening. The rest of the world—Mr. Levin, you can call this trickle-down economics. You can call it whatever you want, but what is irrefutable is the rest of the world is racing to cut their corporate tax rates as fast as possible, and it has been happening relentlessly year after year after year.

And so we have a Tax Code, I would argue, Mr. Chairman, that in the late 1980s and early 1990s was actually competitive. We were below where other countries were. We are in a global economy. There is no putting the genie back in that bottle. We do compete against China and Mexico and Australia and Europe. And we were in a situation where we could sustain a 35-percent corporate tax rate because—guess what?—the rest of the world was higher than we were. Now the rest of the world, according to the latest numbers from the Tax Foundation, is somewhere between 24 and 25 percent.

So this is a 10-percent—what I call this is a tariff that the United States is imposing than our own goods and services. How stupid is that? I mean, really. Why would we want to have a rate that is much higher than—we put every one of our corporations at a 10-percent disadvantage. That is just—look, if you cut me, I bleed red, white, and blue. I want a tax system that brings the jobs back to the United States.

Now, your point is very well taken, Mr. Chairman. How many companies do we have to see week after week after week after week leave the United States, whether you are talking about Medtronic, one of our great medical manufacturing companies; Pfizer; just a week or two ago, it was Johnson Controls. Walgreen's was talking about leaving. I don't know if they have left, but they've been talking about it. I could go on and on. Burger King, another example.

Ladies and gentlemen, how many companies have to leave before we take action? If you don't take action on this, Mr. Chairman, in the next couple of years, I guarantee you we are going to leave—lose more American companies to—and by the way, where are they going? They are going to Ireland. They are going to Canada. They are going to China. Ireland is 12.5 percent. We are at 35 percent. Mr. Chairman, we can't compete under that kind of tax model.

Chairman BRADY. Mr. Moore, before I turn very quickly to Mr. Holtz-Eakin, we are going to make significant changes in the way we tax to move to a pro-growth economy. So should our goal be to make these changes to get to the middle of the pack of our competitors or to move to the lead pack, you know, those top, most pro-growth tax rates in the world? Where should we be setting our target?

Mr. MOORE. So what I recommended in my testimony, and this was based on some analysis that I have done with Larry Kudlow and Art Laffer—I know you are familiar with them—and what we basically recommend is because we are very worried about the U.S. economy right now—I think there is a threat of a recession. I am not saying there is going to be a recession, but we are in a danger zone right now. I think you all know that. We had in the last quarter, the numbers that came out, 0.8 percent growth. If you take out government growth, because you guys grew spending the last quarter, the private GDP was about 0.5 percent. That is getting really close to recession.

So what we recommend is a 15-percent corporate rate, which will bring us below the average. It will still be higher than Ireland and some other countries, but we will be below the average.

And we recommend two other things, Mr. Chairman. You ought to allow immediate expensing for all corporate capital purchases, and we ought to have a repatriation policy of a tax rate of—we tried this in 2005. It was a big success. We raised revenue. We brought money back. Shareholders benefited from it, and it created jobs. If you would do those three things, I think you are putting a powerful punch into the economy.

Chairman BRADY. All right. Thank you. And I apologize. I will be very brief.

Dr. Holtz-Eakin, you have done a lot of study on the Affordable Care Act, the impact, not just on patient care, but the economy as well, and the growth of the—you spent a lot of time thinking about it. So I am going to—in healthcare, on the tax side of the equation, what are the one or two reforms we could put in place to ensure access to affordable high-quality healthcare as well as to improve the economy, your recommendations to us, because this is—will be part of our tax considerations as well?

Mr. HOLTZ-EAKIN. Well, certainly I would urge the committee to look at all the taxes in the Affordable Care Act. It is, in my view, riddled with bad tax policy. Raising revenue in a fair and efficient fashion should be a standard that is applied to taxes in healthcare as well as taxes elsewhere.

In particular, I think the committee should look at what is the future of the Cadillac tax, which has now been put off for a couple of years? It is not very good tax policy. It is very complicated and onerous to comply with. It is not particularly fair. Someone in the 15 percent bracket gets some of their compensation taxed at a 40-percent rate. I don't really understand that. And you ought to consider alternatives which end an open-ended tax subsidy to health insurance that is bigger for more wealthy people and look at ways to get either a cap on the exclusion or a flat tax credit, some cost control incentives and help for lower income Americans in getting private health insurance. I think those would be important.

Chairman BRADY. Great. Thank you, Mr. Holtz-Eakin. I appreciate the testimony today.

I recognize the Ranking Member, Mr. Levin, for his questions.

Mr. LEVIN. And, Mr. Moore, I very much agree with you that tax reform is going to have to be bipartisan. And we started that way here in this committee with working groups, and then Mr. Camp went in a different direction. He did come up with a proposal that was serious. It was essentially discarded by the Republican majority, but a flaw in it, and a very significant one, was the lack of bipartisanship in putting together the proposal itself.

You lose so many people in this country, Mr. Moore, when you say the previous repatriation effort was a success. It was a miserable failure. There is no evidence it created any jobs whatsoever. It maybe increased dividends. And for us to repeat that experience would be a terrible mistake.

I also think that you really sell short what happened during these last 7 years when you compare the crisis that was faced by this administration with the crisis that was faced by President Reagan. I am not saying it wasn't an issue, a problem. It was. I think a lot of the responses were not correct. But in any event, to compare the two is, I think, a serious mistake, and you really sell short what was endeavored.

I can remember hearing from the Bush Secretary of Treasury pleading with us to take action and saying there hadn't been a crisis like this since the Great Depression. And the majority of the votes for the so-called bailout in this House came from Democrats, talking about bipartisanship. So—

Mr. MOORE. Look, there is no—oh, sorry.

Mr. LEVIN [continuing]. You lose—you lose us.

Also, I think in terms of your chart about the recovery gap, early on after the Reagan tax cuts, they increased taxes just a year before I got here. And then we continued to increase some of the taxes during the Reagan administration. So about half of the tax cuts were essentially taken away.

But I would like, Mr. Bernstein, for you to comment on Mr. Hassett's claim that there is now some kind of some magic consensus among economists as to, for example, corporate taxation and supply-side tax policy in general because I think that is a figment of the economist's imagination.

Mr. Bernstein.

Mr. BERNSTEIN. Yeah. I agree with you. And I would argue that my friend Kevin—and I mean that, friend, not in the Washington sense; we really are friends. We write stuff together, so he is a colleague. But I think Kevin is misinterpreting that literature quite considerably, and I will explain why in a second. But I also wanted to clarify some of Steve's comments about the corporate tax, which I think are mostly wrong, but in one sense, we agree, which is that, in fact, as I said in my testimony, the corporate Tax Code really does need reform. And I doubt there are too many people in this room who wouldn't agree that a lower rate and a broader base would be a useful way forward, but I would also point out, as you suggested, that that is precisely what—part of what former chair of this committee, Dave Camp, proposed, and that was DOA, so it is a little bit more complicated.

Another complicating factor is Steve mentioned inversions and talked about countries leaving to avoid paying 35 percent. Johnson Controls was paying a 19-percent tax rate. Now, that doesn't mean that they aren't going to go try to find a lower tax rate somewhere else, but let's not kid ourselves. Particularly when you are talking about multinationals, the 35-percent rate may be the statutory rate, but the effective rate, far, far lower.

The literature that Kevin mentioned does—is by no means as widely accepted as he suggested, and in fact, the quotes that I gave you are quotes that tax experts from both sides of the aisle very much stand by. We disagree that anyone would retract the points that I made.

Was that you?

Chairman BRADY. Yes.

Mr. BERNSTEIN. Oh, sorry.

Chairman BRADY. Time has expired——

Mr. BERNSTEIN. Sorry.

Chairman BRADY [continuing]. Bernstein.

Mr. BERNSTEIN. Can I make a quick point?

Chairman BRADY. Yes.

Mr. BERNSTEIN. Okay. Kevin cited Christine Romer's work suggesting that the administration's estimates were wrong; if they would have incorporated it, they would have been different. That is just patently incorrect. Those effects would have lasted for a year or two, never 6 years. And, by the way, the tax cuts that he is referring to, that Kevin is referring to, was a tax increase on a very narrow slice at the top of the income scale, people above \$450,000. That is not what that literature refers to.

Chairman BRADY. Remind me not to give you extra time. Okay.

Mr. BERNSTEIN. Well, thank you for——

Chairman BRADY. Mr. Johnson, you are recognized for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman.

A few weeks ago, my home town, Plano, Texas, was named America's best city to find a job in in 2016. And not a day seems to go by that some major company isn't moving into that area with new jobs, and there is a reason. It is because the Lone Star State's formula for growth, low taxes and fewer regulations, make a difference. As the chairman is well aware, Texas knows how to create jobs. It wouldn't hurt for folks in Washington to maybe look to see what is going on down there. Maybe it will work in the whole country. What do you think?

Mr. Holtz-Eakin, welcome. Does a slower rate of future economic growth mean for the economy—what does it mean, and Americans' living standards, how will it affect them?

Mr. HOLTZ-EAKIN. As I mentioned in my opening remarks, I think it is quite telling for the projected future living standards. Slower economic growth comes from two things: one, a slower rate of population growth, but more importantly, recent and projected productivity growth is very low. And that is where the living standard comes from.

If we push off into the future a doubling of the living standard every 70 years instead of every 35, we push the American dream further and further down the road, and that is simply something



that makes me very concerned about the next generation and beyond.

Mr. JOHNSON. What are three things that we can do to change that, and can you list them in order of priority?

Mr. HOLTZ-EAKIN. I picked the three that I think are most important in my testimony. I think the committee should continue to pursue a trade agenda. We know that the vast majority of income growth in the globe will be outside the U.S. Certainly the vast majority of consumers will be out there. I think it is an imperative that our workers and the firms they work in have access to those markets on terms that are fair and reasonable, and that is what a well-negotiated trade agreement can provide.

I think tax reform is very important. I will align myself more closely with Kevin on the benefits of good tax policy. They increase the efficiency of the economy and can spur economic growth.

And I think you should have to put entitlement reform on the table. Our entitlements are not serving the beneficiaries well. They need to be better. It is a disgrace to give someone a Social Security system that is going to go broke in 20 years. And they are feeding the red ink that is the problem with our budget.

Mr. JOHNSON. We think tax reforms are important too.

You know, at the end of last year, the total debt exceeded \$18 trillion. It is now on track to reach \$29 trillion in 2026. And we have deficits of hundreds of billions of dollars that are adding more and more to that debt each year. Some are suggesting that the deficit and debt are not a problem. Do you think our growing debt represents a threat to our economy?

Mr. HOLTZ-EAKIN. Yes, I do. If you look at the CBO budget projections, which are what happens on autopilot, where nothing gets done, the deficit is about \$1.3 trillion 10 years from now. \$830 billion of that is interest on previous borrowing. Interest is growing—net interest is growing at over 12 percent a year in those projections. We are borrowing today, our previous borrowing, that is just unwise. It is also unsustainable and dangerous to the economy.

Mr. JOHNSON. Thank you, Mr. Chairman. I yield back.

Chairman BRADY. Thank you.

Mr. Rangel, you are recognized.

Mr. RANGEL. Thank you, Mr. Chairman.

Mr. Moore, I was choked up to tears when you brought back the days of 1986 bipartisanship. And you have to realize at that time, Members talked with each other regardless of their party. And if somebody was saying that they wanted to have a tax cut or tax increase, people would say, "Why," not whether that is the party line. So I think you threw the ball in the court of the Members of Congress, but when you talk about our corporate tax cut being so high, it is my understanding that some 26 of the major Fortune 500 corporations pay no taxes at all, that General Electric had \$27.5 billion in profit, and they got a refund in terms of it. And so the private sector, I really think, is the greatest impediment because those that have this extraordinarily unconscionable tax rate don't pay the tax rate. So they are that not coming in here screaming about reform, but you are not going to find any Democrat that doesn't believe that we should reduce our corporate tax rates, but it is hard to find Republicans willing to put their names on any-

thing, no matter how much of a distortion of the Tax Code it is, if someone could say they increased someone's taxes. And so we have a problem in abusing each other with rhetoric.

And I think when we talk about whether or not we are using dynamic scoring or status current scoring, that it is a coverup for just saying cut taxes and not make it pain so much, but if we had people like you, Mr. Moore, that have been around the Hill and realize that a lot of the things that we do is because we don't want to have a label, but basically a lot of us, Democrats and Republican, know that compromise and working things out is the only way to get something done.

It is almost unlawful—if I was to ask you to prepare a case as a representative for this country, say, for TPP, wouldn't you not say in order for that to be effective, that we would need infrastructure and that we would have to invest in it, and you could come up with some dynamic scoring as to how much the railroads and trains and planes would do, you could do it? If I was to ask you, what would make America great in terms of technology, couldn't you come up with some dynamic scoring that by keeping people out of jail and unemployed and having disposable income, they could buy and create jobs? You could do it. So I don't give a darn what economists call it. If we are not talking to each other, and dynamic scoring sounds like cheating to us, we don't care how rational it is. And if spending is something, even for the best of things, healthcare, education, building roads and whatnot, if that is going to mean that you can't be a good Republican, it doesn't work. So why don't the Chamber of Commerce and the Business Roundtable get rid of what is happening today and get back to 1986, where we would say, what did you mean by that, or can you change the language, or can you show what is going on, because the road that we are traveling is now the only people that are really not getting it are those people who had the hopes, the dreams that in this country, no matter what stage you are in, life can get better. And I don't see why the middle class is not considered good for America if you are rich or poor. If you are wealthy, you need middle America to invest.

And so I yield back the balance of my time, because you people who are testifying have to recognize, it is hopeless for us to talk with each other when you start talking about dynamic scoring because you are talking about tax cutting and you are not talking about paying for the tax cuts, but if you talked about education, infrastructure, and bringing closer—ending the disparity in wages whether you are White or Black, Republican or Democrat, you are talking about what we used to talk about in 1986. And I wish we can get just some memory, as you have, of the days we have done that.

Thank you, Mr. Chairman.

Chairman BRADY. Thank you.

Mr. Nunes, you are recognized.

Mr. NUNES. Thank you. Thank you, Mr. Chairman.

So I remain concerned that tinkering with the Tax Code is really going to have much of an impact at all because the income tax is just completely inefficient. The Congress picks winners and losers all of the time, and it is tough for us to get rid of all these winners

or losers that we have picked over the years. And so I have long worked on a modified version of the X tax that I think most of you are familiar with, that does away with all of the loopholes. I think it is something that has bipartisan support, but because you are getting rid of essentially the income tax that has been in place for 100 years, we need to properly vet a proposal of that magnitude.

So my question—and I will start with Mr. Eakin—if this committee were to vet a modified X tax like the one I have proposed, what are the areas of focus that we should focus on as we review that proposal because if you make a change like this, you really are doing something that has never been tried globally before?

I will start with you, Mr. Eakin.

Mr. HOLTZ-EAKIN. Well, I have—I am a big fan of X tax style proposals, and they have some great efficiency virtues in that by expensing capital equipment, you equalize the tax treatment of capital investment, investment in skills and education because employers can subtract those. Because labor and capital are both expensed, your R&D, which is made of labor and capital, is expensed. You have now equalized the margins by which the economy grows: skills, physical capital, innovation. And we need to grow, and we need to make sure that we take the fastest route. I think looking at those and making sure those kinds of incentives are put in place are very important.

Second is, think carefully about the X tax's distributional consequences because one of the things I like about X tax proposals is it is essentially turning the tax system into a traditional style IRA. You get to subtract a contribution, deduct it, expense it, and then it gets taxed when it comes out equally, interest, dividends, capital gains, no distortion on that front. That latter, I like a lot, but what gets unrecognized too often is when you do it that way, if someone gets lucky, right, so you may invest in a company and the rest of the global competition gets wiped out through an earthquake, stock scores, you make a ton of money, we capture the windfalls in that kind of a tax system, unlike one where you don't get the deduction; you get to keep everything afterwards, a Roth style IRA. So I think that it is a better distributional system than is typically perceived.

And, finally, in the end, this is going to be a progressive consumption tax, tax on the consumed income base, I think that is exactly right, and—but you are going to have to look at how it integrates with the low-income support system and the poverty network where you set thresholds to begin that consumption, can't be done independently of what we are doing with the social safety net and the work incentives elsewhere.

Mr. NUNES. Thank you, Mr. Eakin.

Mr. Hassett.

Mr. HASSETT. Thank you for being a leader on this topic, Mr. Nunes, too.

You know, again, this is something—and it goes back to what Mr. Rangel was saying—you know, I don't think that my testimony earlier, for example, was about dynamic scoring. It was about thinking about if we do this, what happens to the economy. And I exactly applaud your analysis that if we are going to that, we need to do it for everything. So should we build a bridge is some-

thing we can analyze, like, what is it going to do to the economy if we build a bridge? The consumption tax is something, again, it is just completely resolved in the literature. You are a science denier if you don't recognize that——

VOICE. Careful, careful.

Mr. HASSETT [continuing]. Switching to a consumption tax is going to have positive effects on the economy. And it is very, very intuitive. The members of this committee need to understand, if you want to have higher consumption 5 years from now, where are you going to get the higher consumption? Well, you are going to have a higher wage, or you are going to have money in the bank. If you have money in the bank, then you could draw some of the money out of the bank or the interest on the money in the bank, and then you could use it to have higher consumption 5 years from now.

The same is true for the economy. We want our economy to have higher consumption 5 years from now, and this is all Americans, then we have to have assets that we can draw consumption from. And so if we have something like the X tax that Mr. Nunes has been working on for years now, then the way you avoid the tax is you save for tomorrow. And so then tomorrow, Americans across the board have more stuff that they can use to finance their consumption. And so it is not magic. It is not hokum. It is just simple arithmetic that if we encourage people to acquire assets, then they can have higher future consumption.

And so I applaud you, Mr. Nunes, for pursuing this.

Mr. NUNES. Thank you.

I know I only have 30 seconds left, that we are not going to get to Mr. Bernstein or Mr. Moore.

But maybe, quickly, Mr. Bernstein, I don't know if you have looked at an X tax or not.

Mr. BERNSTEIN. I will try to be quick.

I think both of my colleagues made many good points. I take both of their points about efficiencies therein. And I think Doug's point is really important about the distributional impacts of consumption tax on those who consume but don't save.

The only thing I would push back about Kevin's point is that, in fact, the price of capital is very low, it is very cheap, it is very excessive. That is not a binding constraint on investment right now.

Mr. NUNES. Thank you, Mr. Chairman. I know I am out of time, but, Mr. Moore, I look forward to getting your response maybe at a later date.

Thank you, Mr. Chairman. I yield back.

Chairman BRADY. Thank you.

Mr. McDermott, you are recognized.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I have listened very carefully to the four of you for almost an hour now, and I have never heard the subject of student debt raised.

Now, I would like to talk a little bit about my own experience. In 1970, I was a physician. I came out of the military. I moved to Seattle. I bought a house for \$35,000. I was moving into the future, right? Today, you have 41 million people who are carrying \$1.2 tril-

lion worth of debt, and it is putting a damper on our economy that none of you have even mentioned. It is surprising to me.

The average debt of a student coming—62 percent of the students in this country come out of college \$35,000 in debt. Their money is going to go to that debt, not to buying a house in Seattle. And there is no way you can have that kind of debt and consider investing in the society. And kids are deciding now not to go to college because they can't see the benefit. Or I have kids in Seattle who are saying: I am going to Europe. I am going to Germany. I am going to France. I am going because college is free.

And what is hard for me to understand is how you can avoid seeing the impact. These kids get these debts not only for them; their parents sign on to the debt, which changes their ability to retire because they have this big overhang of debt that their kid is still carrying. Seventy-seven percent of kids in this country say student loans are a major obstacle to obtaining a mortgage and buying a house.

Now, if you want to talk about ObamaCare or EPA—Mr. Levin because he had to go to a meeting about Flint, Michigan. That is what you get when you get rid of regulations. If those are what you think will stimulate the economy, when is somebody going to talk about the young people in this country who are dragging debt no matter what they do?

I worked on the Great Lakes every summer. I made enough money to pay for the whole school year. You kids work all summer now, you can't pay for one quarter. You can hardly pay for one course.

And so I would like to hear you talk about student debt. Do you think it makes any difference, what happens to the kids in this country? Or do you think, why should they have to pay 7 percent when businesses can borrow at the low rate, 1 percent, 2 percent, something like that? They can't renegotiate their rates?

We can't even get a hearing on a bill like that. I put the bill forward. I would like to hear you say what you think about student debt.

Let's start with you, Mr. Eakin.

Mr. HOLTZ-EAKIN. So I think you said two important things that are fundamental to this. The first is you used to be able to work during the summer and pay a whole quarter or semester. The fundamental problem is not the debt or the equity investment in higher education; it is how much higher education costs and what some kids are getting for it. That is a value proposition, and that is the fundamental issue that has to be dealt with.

It is very similar to the kind of discussions we had back in 2006 and 2007 about healthcare reform, where there was a bipartisan agreement that we are spending too much on a product of highly uneven quality and there was an enormous amount of Federal subsidy going into it. The same conversation has to happen on higher ed.

The second is this hearing is about better economic performance. There is no segment of the population that has been hit harder than young people by the Great Recession and the poor recovery, and that has exacerbated the difficulties they have in these debt-financed college educations.

So, I mean, start with the fundamentals, and then figure out how we can target more effectively——

Mr. MCDERMOTT. Why can't we have the banks allow the rate to go down? Or why can't we get kids into the Federal system and finance it all from the Federal Government at 1 or 2 percent rather than doing it the way we are doing it now, which is——

[Phone rings.]

Mr. MCDERMOTT. Excuse me here a second.

Chairman BRADY. If you are going to break into song, Mr. McDermott, we will need a warning on that.

Mr. MCDERMOTT. Why can't we have renegotiation of loans with banks for students? Just give me the answer to that. Why can't students renegotiate?

Mr. HOLTZ-EAKIN. Private lending has been essentially taken out of the Federal financing of higher education, and so there are no banks to negotiate with. And the rates are set in law by Members of Congress, so I would——

Mr. MCDERMOTT. It is up to Congress to drop the rate——

Mr. HOLTZ-EAKIN [continuing]. Get a mirror.

Mr. MCDERMOTT. If we drop the rate on taxation from 35 percent, maybe we could drop the rate on student loans to prime rate.

Chairman BRADY. All time has expired.

Mr. Reichert, you are recognized.

Mr. REICHERT. Thank you, Mr. Chairman.

Six years ago, President Obama set a bold goal of doubling exports by the end of 2014. I very much support the goal of increasing U.S. growth and creating jobs through increasing exports. Exports alone support 11.7 million American jobs, and the number of jobs tied to trade across the country has increased by over 110 percent since 1992. In my home State alone, this number is even higher. It is 129 percent, Washington State, the most trade-dependent State in the Nation.

And because of this, members—as a member, one member, along with Pat Tiberi, who is not here today, and Mike Kelly, members of the President's Export Council, we have been pushing the administration to focus on new market access through high-standard trade agreements to meet this goal. Since that time, the administration has launched a series of negotiations that I hope will yield ambitious trade agreements resulting in more good-paying jobs in America.

I chair the Trade Subcommittee, so my question obviously will focus on trade. I am committed to strong oversight of these negotiations, including our negotiations for a U.S.–EU trade agreement and working with the administration on a way forward on this Trans-Pacific Partnership that is winding up hopefully sometime in the near future. We must get this right, however. It is too important for our global leadership and economic growth not to.

So I noticed, Professor Holtz-Eakin, in your testimony, you mentioned trade as one of your key points in growing the economy. In fact, I think your statements were: It is crucial to economic growth. It increases market access, increases productivity, of course then leading to additional job growth in the United States.

Can you expand a little bit more on the importance of trade and how it plays that strong role in growing our economy? And then,

also, I think it might be important to mention maybe some of the evidence that you have to support that statement.

Mr. HOLTZ-EAKIN. So I think broad economic engagement with the rest of the world is central to our future. As I mentioned before, we know there are large growing markets outside the United States, with the vast majority of consumers and income growth there. I think it is beholden to the U.S. to provide our workers access to selling their skills in those markets on terms that are level and, you know, represent the best of well-negotiated trade agreements.

A good example of the kinds of things that go on with trade is: You think of in the nineties when we thought we couldn't compete in semiconductors anymore, right? It was all going to go away. We eliminated all tariffs. There was an agreement, trade agreement, to eliminate tariffs on semiconductors around the world. The U.S. didn't lose. It absolutely came back and has high-productivity, excellent semiconductors.

We can compete with anyone. The productivity pressures that come from trade generate productivity increases and allow employers to pay their workers better. That is why you get about a 20-percent bump in compensation in export-related industries and companies. And I think we ought to be consciously trying to, you know, pursue engagement all around the globe to get the right terms.

And as a practical matter, if you look back at the history of the GATT and the WTO, I would like to believe, as a Ph.D. economist, that the virtues of good economic policy drove that. It didn't. The reality was we also faced a threat in the Soviet Union. We knit together a Western alliance on both economics and security grounds to face that threat. We need to think that way in the 21st century, as well, and knit together strategic alliances on economic and other grounds. And these trade agreements are great ways to do that.

Mr. REICHERT. Very quickly.

Mr. HASSETT. Yes. The one thing about it, though, is that the two issues are very connected. So we for sure should expand as much free trade as we can. But if we don't fix the Tax Code too—

Mr. REICHERT. Oh, yeah.

Mr. HASSETT [continuing]. What is going to happen is that they are going to produce the goods in Ireland that they sell to the place that we have the new trade deal with and that U.S. workers are going to be left behind, like they have been, because we are the high corporate tax place.

And so if we really want to be a force multiplier with trade, then we have to fix the Tax Code as well.

Mr. REICHERT. I totally agree with you. I think they are indeed in partnership.

Finally, our committee considers policy ideas that will deliver growth and opportunity for all Americans. We focus on individual policies that are working, such as employee ownership. I want to thank Mr. Bernstein for his support of an ESOP bill that Mr. Kind and I are sharing together and proposing.

And I yield back.

Chairman BRADY. Thank you.

And, Mr. Neal, you are recognized.

Mr. NEAL. Thank you, Mr. Chairman.

Having served here for a long time, I have a pretty good institutional memory of some of the facts that have been thrown out here today. And the argument, conveniently, as we move from Reagan to Obama, left out Clinton and Bush.

So I am invited to the White House within weeks of George W. Bush's election with 11 others—the one I can recall that was there for the record was Cliff Stearns—and sat next to the President at the big table, and he laid out his plan for tax cuts. Paul O'Neill was there, and Vice President Cheney was there.

And the President asked me what I thought. I was next up after he made the presentation. And I said: Mr. President, why don't we stick to the position that we are currently on and offer modest tax cuts to middle-income Americans and continue to pay down the debt? Well, obviously, he didn't accept that suggestion because taxes were cut by a trillion-three in 2001 and a trillion more in 2003.

So we take the Clinton surplus, and, with the tax cuts, we direct them to people at the very top and argue that that is going to trickle down to people at the very bottom. And, now, as economists, you must acknowledge that it was very slow in terms of growth. The whole notion of the Bush tax cuts were to speed up growth. It didn't happen.

The Clinton position—and Bush I, incidentally—brought us to unparalleled prosperity of 23 million jobs, 4 balanced budgets.

So we continue here to argue over this notion that if you simply cut taxes for people at the top it is going to be great for everybody across the country. And there is very little evidence to support that conclusion, including the argument about tax cuts paying for themselves.

So you are talking to somebody who is very interested in using many of the arguments that you have all offered, because I read your stuff pretty faithfully, in trying to figure out a path forward with corporate taxes and personal income taxes which might put the country on a trajectory of pro-growth.

But I want to come to Mr. Bernstein for a moment, because I want to tell you, in western Massachusetts, the money that we used for rail with stimulus worked on the north-south line—New Haven, Hartford, Springfield, and on to Vermont.

And as it relates to the Internet in rural western Massachusetts, where private companies looked at the opportunities there to extend high-speed Internet, they couldn't do it. We used that money for middle mile opportunities.

So, Mr. Bernstein, would you comment on those?

Mr. BERNSTEIN. Yeah. This brings us to something we also haven't talked about which is really critical. If we believe—and I am very much with you on this, Representative Neal—that part of dealing with our slow productivity growth problem is greater investment in public infrastructure—and you give a couple of great examples there—we are not going to be able to do that if we butcher our revenue base by reckless tax cuts.

Now, that doesn't mean that every tax cut is a reckless tax cut. One of the things I haven't heard discussed here today is revenue neutrality. Any reform to, say, the business side of the Tax Code



should have that as the lowest bar, but, as I said in my testimony, that is not enough. We are going to have to do better to make these investments that are so critical to our public goods and to our infrastructure that is too often deteriorating. You have managed to take the initiative in your State, and I very strongly suspect you are going to have productivity gains to show for them.

In context of some of the comments that have been made here, under Ronald Reagan—and you will remember Steve’s chart—the GDP was going up very quickly. Debt as a share of GDP increased 15 percentage points, from 25 percent of GDP to about 40 percent of GDP. Okay? So you can’t make the kinds of investments you need if your tax cuts leave you in such an indebted situation even amidst relatively strong growth.

The Clinton years, as you suggested, go precisely the other way: very strong growth, strong productivity growth, productivity growing a point and a half faster than it is growing now, really remarkable productivity growth, and budget surplus, not budget imbalance. What did President Clinton do? He didn’t take the advice of the supply-side tax-cutters. Quite to the contrary.

So I think that the punch line of your comments is that, A, we have to invest in public infrastructure; B, that is going to take more revenues, not less; and, C, if we follow the supply-side tax problems, we are going to be ending up in the same Ronald Reagan/George W. Bush position of not having the resources to make those critical investments.

Mr. NEAL. Thank you, Mr. Chairman.

Chairman BRADY. Thank you.

Dr. Boustany, you are recognized.

Mr. BOUSTANY. Thank you, Mr. Chairman.

I think what hasn’t been said here yet is that America is an exceptional Nation. And I think all of us believe that in our heart. Most Americans do. I have seen it when I have gone down to a shipyard in Morgan City, where workers, those who are still working, have the pride in their eyes in the craftsmanship that they have been able to put together to build vessels. Same in Cameron, where we have oil rigs that are stacked, but some are still working to fabricate, to hang on to those jobs. And those are good-paying jobs, much better paying than the average. The fact is, workers, American families are hurting, and they are hurting bad.

I read the testimony last night, all of your testimony, and I can tell you, the charts, the graphs are depressing. Point-seven percent growth in the last quarter of the year? Absolutely depressing. I put it down. I picked up Ian Toll’s first volume on the Pacific War, our actions in World War II, and read the chapter on Midway. And it gives me hope that we are going to come out of this, because Americans always face a challenge and we always have an innovative response. That is why we are exceptional.

We came out of the recession because we had a bump in exports and we had the shale revolution, and oil and gas production soared that helped us come out of that recession. And both are down now, as is consumption, manufacturing—all the indicators for our economy. We have to change it. That means understanding what is going on with trade and leading, as Mr. Reichert just talked about. It is about restoring growth, because we cannot restore American

leadership without economic growth. Trade is key. We have to re-tool our Tax Code. I mean, right now, American companies are really struggling because of the Tax Code.

And on the international side, whether it is the BEPS coming out of OECD, the hostility coming out of Europe on State aid, the adverse merger and acquisition activity, if we don't do this with a sense of urgency, we are going to lose. We need to understand the linkage between trade and energy. And we just opened up LNG exports and the potential for crude oil exports, but none of these things are going to solve that broad problem until we embrace this energy sector and understand how we retool our energy strategy to fit the 21st century. These things will make a major difference.

My State of Louisiana understands this, but the Washington dysfunction here, the lack of a political will, and the lack of the understanding to sit down and have a real conversation about these issues and how we solve these things is what is holding us back. We have to take the bull by the horns here and start solving these problems for the sake of this country.

I just want to focus, with the little bit of time I have left, on the international tax side of things. And I alluded to it with the urgency in which we need to approach this. But economic growth and prosperity and the well-being of American companies doing business all over the planet links directly back to the welfare of American families.

I think you guys—would you all accept that concept? I think it is pretty intuitive.

So if we don't stop the loss of major U.S.-headquartered companies—I mean, we are hemorrhaging this. We have had several of them just in January, major, high-profile ones, not to mention the lower-profile cases, and the fact that U.S. companies can't even compete in a merger and acquisition market today. We are losing in the global game. We have to stop it.

Do you agree that this loss is felt all the way down into small communities across this country, whether it is suppliers or service providers that are linked to that economy, or even those that may not have that direct link, because of the drain on our economy, it is having an impact?

Mr. Holtz-Eakin.

Mr. HOLTZ-EAKIN. I think this is a national tragedy. And you look at the Budweiser-InBev merge. Headquarters leaves St. Louis for tax reasons. You know, Budweiser was, the Anheuser-Busch brand was that town. And what happens to the Boy Scouts, the Girl Scouts, you know, the opera, anything like that, the suppliers in the local area? If you lose the headquarters, you start to lose the R&D. If you lose the R&D, you lose the manufacturing.

We are losing the headquarters in every international merger and acquisition. We simply can't compete. We have gone from being the global economic predator to the prey. And this is not going to stop until the Tax Code gets changed. There is just no way around that.

Mr. BOUSTANY. Others?

Mr. MOORE. You know, I just want to touch on something you said about energy. We just did a study that finds that the value—I mean, look, the shale, oil, and gas revolution—you hit it right on

the nose. Without the shale, oil, and gas revolution, we would not have had an economic recovery. It had nothing to do with the economic recovery. Just look at the statistics. On net, all of the new jobs that were created from 2008 through around 2013, 2014, all of the net new jobs were in the shale, oil, and gas revolution. This is what bailed us out.

Now, we are in a situation today because of these technologies—and, by the way, the technologies are getting better and better and better every single day. We have a massive lead over the rest of the world in this industry.

Now, here is what is amazing——

Mr. BOUSTANY. We don't want to repeat the same mistakes we made in the seventies with that technology.

Mr. MOORE. You have it exactly right. But let me just throw out one statistic, if I may, to you. The value of American oil and gas at current technology, the recoverable oil and gas—and that has more than doubled over the last 10 years because of these new technologies—the value of that is \$50 trillion—\$50 trillion to the U.S. economy. This is the single biggest priority we have as a country. We are sitting on a treasure chest of \$50 trillion of assets. And this is under Federal public lands.

Now, Mr. Chairman, this is an important point. What is the value to this of the taxpayer? You are talking about how we are going to pay for all these tax cuts. I will tell you how you are going to pay for it. We drill. And we have leases, and we have tax payments, and we estimate that the value of this asset to the Federal Government is about \$3 trillion in tax payments and leases and royalties.

Why don't we do that? If we need revenues, why don't we drill for this oil? I mean, we have a President——

Mr. BERNSTEIN. Oil is \$30 a barrel. Do you want more supply?

Mr. MOORE. We have——

Mr. BERNSTEIN. It makes no economic sense.

Chairman BRADY. All time has expired.

Mr. MOORE. It does because——

Mr. BOUSTANY. Thank you, Mr. Chairman. I appreciate——

Mr. MOORE [continuing]. The price of oil isn't going to stay at \$30 a barrel.

But the point is this: that we have a President right now who says, keep this \$50 trillion asset underground. It is one of the dumbest policies. It is almost unpatriotic to say we shouldn't be drilling for our assets when you are talking about jobs that pay \$80,000, \$100,000, \$150,000 a year.

Chairman BRADY. All time—thank you, Mr. Moore. All time has expired.

Mr. MOORE. Sorry.

Chairman BRADY. We went over just a bit on that one. We will take it out of Mr. Roskam's time.

Mr. Doggett, you are recognized.

Mr. DOGGETT. Well, thank you so much.

I am all for taking the bull by the horns, but not just for more bull, of which we hear a lot in this committee.

I am pleased that Dr. Holtz-Eakin has been unequivocal in his prior testimony to the committee on one point with which I fully agree.

And that is your comment, Dr. Holtz-Eakin, that, quote, "I have never believed that tax cuts pay for themselves." That remains your position today, does it not?

Mr. HOLTZ-EAKIN. Yes, it does.

Mr. DOGGETT. And while there may be other reasons for supporting what this committee approved back in December in a massive tax cut approving so many tax expenditures that were made permanent, you do not disagree with the Committee for a Responsible Federal Budget, on whose board you recently served, that when you consider the interest cost and everything of borrowing the money rather than paying for those provisions, it added about \$830 billion to the national debt over 10 years.

Mr. HOLTZ-EAKIN. I actually haven't seen their publication, but I think we know from the CBO baseline, which incorporates that, that that is the position we are in.

Mr. DOGGETT. That is right. That is about what the CBO estimated, as well. And, indeed, about \$2 trillion added to the national debt over the next two decades.

And I think the problem is that, while everyone on the committee enjoys the opportunity to vote for a reduction in taxes, as our former chairman Dave Camp found, there are not very many people that want to vote to pay for those revenue reductions. And as a result, tax reform—and I think this will be true of the international tax changes, some of which I support, that Chairman Brady spoke about yesterday—tax reform is just another way of saying: Cut taxes, borrow more money to fund whoever has the strongest lobbying team here.

Now, the stated purpose of this hearing is to provide pro-growth policies that deliver opportunities for all Americans. I think that would be something new in this committee, because, in fact, the way we have created so many loopholes and advantages for the advantaged in the Tax Code, it has played a major role in fostering inequality in this country.

If you look back as far as 1965, the average corporate executive was being paid a salary that was 20 times that of the average worker, and today we know that is closer to 300 times the average worker. And yet this committee continues to support, a majority of it, a taxpayer subsidy for multimillion-dollar executive bonuses.

A major factor contributing to inequality in our country, the inequality that is concerning people of differing political philosophies today, is the Tax Code and the way it has been altered to benefit the few.

A second factor that is important to note here is that there are things that might be done to encourage America's competitiveness other than just changes in taxes.

And so if there is an issue about how to provide more young Americans an opportunity to get all the education they are willing to work for, how to train our workforce so that people that lose one job have a chance of getting a better job, every dollar that we would invest there, that has to be paid for under our budget rules by cutting something else.

But you can go on a spending spree with tax expenditures and never pay a dime. And that is what the Congress did in December, and that is what is being proposed for this year as well.

Dr. Bernstein, specifically with regard to those corporations that renounce their citizenship and decide to reincorporate in name only abroad to avoid paying their fair share of American security, do you support the concept of an exit tax similar to that that applies to individuals who renounce their citizenship in order to dodge taxes?

Mr. BERNSTEIN. Yeah, I think the exit tax would be a useful idea. It would build on some of the efforts of the Treasury Department, which are constrained because they can't write legislation as this body can.

And, in fact, I think you made an important point in passing there that often gets left behind. We talk about these inversions as if companies are moving everything overseas. I agree with my fellow panelists that we lose too much when headquarters are moved. But, in fact, oftentimes they are just moving their tax mailbox, as far as the IRS concern, booking profits in other countries with lower tax rates.

And it will be a kind of race to the bottom if we try to do that, especially if this body follows a kind of CutGo, as opposed to PAYGO, where not just spending cuts have to be offset but tax cuts as well.

Chairman BRADY. All time has expired.

Mr. DOGETT. Thank you, Mr. Chairman.

Chairman BRADY. Thank you.

Mr. Roskam, you are recognized.

Mr. ROSKAM. Thank you, Mr. Chairman.

Mr. Holtz-Eakin, can I ask you to give us some insight from your previous assignment as Director of the Congressional Budget Office? And here is our frustration. We have had a discussion about growth and so forth and the characterization of dynamic scoring and static scoring, and it is sort of a shirts-and-skins argument on that. But can you give some insight to a frustration that I have?

So there is significant waste, significant fraud, significant abuse. The fraud numbers, for example, in Medicare blow your mind. The fraud numbers in EITC blow your mind. We are talking billions and billions and billions a week. And yet, when there are legislative proposals that CBO is asked to score, they come up with this catch-22 sort of thinking, and that is: Well, that is going to cost money, the remedy is going to cost money, and therefore you are not going to save money.

Can you give us some insight into this ridiculous catch-22, only-in-Washington-D.C. approach? And, more specifically, how can we fix this? Because this is just too absurd for words.

Mr. HOLTZ-EAKIN. Well, we have certainly gone to the weeds, sir, and your fellow committee members will regret the hearing.

Okay. So there are a couple different things going on. First, the basic act of scoring says enactment of the legislation causes something to happen. So that, in this case, involves some sort of implementation of recoveries or antifraud or something in the executive branch. If that linkage isn't firm and secure, CBO cannot and will not score it. So that is one issue to check.

Second, in its wisdom, Congress set up rules for the budget committee and CBO that basically said you cannot simply appropriate a dollar to the IRS and say, "Go collect some money," decide that they will collect a dollar and a half, and then go spend the extra fifty cents. This was essentially a way to rein in—and I say this lovingly—the appropriations committees from simply appropriating money that they could then spend more.

That particular decision meant that anytime you spend money, which is what you are frustrated by—you are spending some money, but you think you are going to get something back—you have to demonstrate that the money in the legislation delivered to the agency a new tool not previously in existence that will in fact improve recoveries or prevent more frauds. And the new-tool test is the thing that is driving you crazy. If you are just giving them more money to do the same thing, you don't get any credit for recoveries and the like.

And that is a—

Mr. ROSKAM. What is the remedy? Is it reformation of the Budget Act? Is that where this—

Mr. HOLTZ-EAKIN. Yeah, I mean, there is a big need for a reform of the Budget Act. It is long overdue. You know, it is 50 years old almost, and there are lots of things about it that need to get fixed. And those kinds of things are incredibly frustrating because it does stand common sense on its head.

Mr. ROSKAM. That is gentle, "stands common sense on its head." I am with you.

Mr. HOLTZ-EAKIN. Well, that was my job. I am a professional—

Mr. ROSKAM. It denies gravity.

So, Dr. Hassett, there was an interesting interchange that you had with Mr. Bernstein a couple of questions ago about interpretations of the new tax literature. Could you just respond to that?

Mr. HASSETT. Yeah. Jared asserted that I am making some kind of mistake, and I can promise that I am not. And I can, you know, meet with Jared, who is a close friend. We have written papers together, which means he has written at least one good thing in his career.

But I am happy to run through. I mean, again, you can just—the staff can grab the articles that I cite in my testimony and have a look at what they say.

Absolutely, the idea that if you have an incentive for something that you get more of it and if you have a disincentive for something that you get less of it, you know, should not be a contentious idea. The question then is, how much?

And it sort of befuddles me why someone would say that, you know, you could have much higher taxes but not create any disincentives, not cause any harm. And the zero position on that is something that I don't think is really defensible in the literature at all. And that seems to be where Jared is.

So he is not only saying that I am incorrect when I just, you know, am reviewing the literature with citations, but he is making a point that I don't think that there is a good citation for. In fact, the article that he does cite in quotes leaves out a bunch of the papers that they just don't like the result of, apparently.

Mr. BERNSTEIN. Can I respond quickly?

Mr. ROSKAM. Quickly.

Mr. BERNSTEIN. Yeah. The articles that I quote are just articles from the tax literature as well, so this is a debate.

But I will say I think Kevin is wrong both on the facts and the theory, because when you raise a tax, yes, you will lead someone to say, "Gee, I want to work less," on one side, because this is called the substitution effect, but also they might say, "I want to work more because I now have a lower after-tax income. I better put in more hours." That is called an income effect. Both of those—

Chairman BRADY. All time has expired.

Mr. BERNSTEIN [continuing]. Are theoretically germane.

Chairman BRADY. Thank you.

Mr. Smith, you are recognized.

Mr. SMITH OF NEBRASKA. Thank you, Mr. Chairman.

And thank you to our panel. This, I believe, is a very important hearing. A lot of moving parts in our economy, certainly, across the country. I represent a constituency in Nebraska, and some of the States around us, we have had fairly strong economies throughout a lot of this time, although we are still affected by the weaker national economic recovery that we have experienced the last 7 years.

Dr. Holtz-Eakin, you have done a lot of work on the ObamaCare, ACA, whatever one wishes to call it. Nebraska had the first collapse of a co-op—CoOpportunity Health it was called—the first of the community-oriented and -operated health plans created by ObamaCare. That was the first to collapse. Eleven additional co-ops have collapsed, out of the 23 created. And, obviously, that has an impact, leaving a lot of folks without the coverage that they were promised, or perhaps they were moved over to that against their preferences.

But now we also have reports of major insurers, such as UnitedHealth and Humana, leaving the health exchanges. And I would say these are major losses and certainly contribute to what seems to be a growing dissatisfaction of the outcomes of ObamaCare.

And I was just wondering if you might comment on what we might expect, economically or other dynamics out there, as a result of these new developments, newer developments, in ObamaCare.

Mr. HOLTZ-EAKIN. I think there is good reason to be nervous about the stability and future of the exchanges under the Affordable Care Act.

The reality is that enrollments grew however quickly you might want to think and then have just leveled off. We know that the people who buy health insurance first are those that need it the most, and the insurers' losses have proven that this is an expensive population, more expensive than anticipated. The co-ops, who had the dual handicaps of being highly inexperienced and using someone else's money—bad incentives always—have gone out of business on those losses. The major insurers, the Blues and others who have done this for a long time, are losing money in a big way.

And the future is sort of in doubt. One possibility is these are simply—they are going to try to raise premiums in the traditional fashion and drive people out of exchanges, and they go into a death

spiral. I doubt that Congress has the ethic to throw more money in and just turn these into glorified high-risk pools, where expensive people get subsidized to get their care.

I think it is a deep concern. It is a budgetary concern. It is an insurance concern. And it is certainly a healthcare concern, because when people lose their insurance, as they did when the co-op collapsed in Nebraska and Iowa, they have to change provider networks, and this is always a bad thing for outcomes.

So we are not in a good situation, and it is not obvious what the next step is going to be.

Mr. SMITH OF NEBRASKA. So, from a consumer standpoint, what do you think consumers should see on the horizon? Perhaps any changes that they should expect or try to plan around?

Mr. HOLTZ-EAKIN. The thing they face most imminently is higher premiums. I mean, these insurers are losing a lot of money. There is no other place to go than to raise premiums. So we have seen sharp premium increases already in the benchmark silver plans, and we have seen the kinds of disguised premium increases that come with narrower networks, higher copays and deductibles. That is the imminent threat.

The bigger problem is insurers leaving. United has said they may leave. Aetna is talking about leaving. That diminishes their choice. There is a lot of evidence that with diminished choice comes less competition and higher premiums yet.

So, in my view, whatever you thought of things when it first passed, it is not evolving in a very beneficial way for consumers in the individual market.

Mr. SMITH OF NEBRASKA. Thank you.

Mr. Moore, I know you have done a lot work on the national economy, and I certainly appreciate the graphs that you have submitted here. What kind of national impact do you think, national economic impact, we should see on the horizon because of the failures of ObamaCare?

Mr. MOORE. Did you say the national impact of ObamaCare?

Mr. SMITH OF NEBRASKA. Yes. Economic impact.

Mr. MOORE. Look, I am not an expert on health care, but I do think one of the things I would recommend to you that would be a stimulus to the economy would be to lift the 50-worker rule. I can't tell you how many times I talk to employers, probably you know people in your own districts, who say, "I will be damned if I hire a 50th worker." Because what you have created is a cliff. Once you hit that 50th worker, not only does the insurance mandates apply to that worker but every one of your employees. So I would raise that to 200, 250 workers.

Look, we still have a lot of unemployed Americans in this country. Why in the world would we pass a law that actually encourages employers to hire fewer workers? I never really could understand the logic of that. I mean, there is a term for this now that is going around the country among employers. They call themselves "49ers." I am not talking about the San Francisco 49ers. These are companies that have capped their employment. I bet every one of you in your districts knows employers who have come to you with the same problem. We ought to fix that right away.

Chairman BRADY. Thank you.



Mr. SMITH OF NEBRASKA. Thank you.

Chairman BRADY. All time has expired.

Mr. Thompson, you are recognized.

Mr. THOMPSON. Thank you, Mr. Chairman.

Thank you to the witnesses for being here.

You know, I don't have the institutional memory that my friend Mr. Neal has. I haven't been here that long. But I do remember very precisely the night that I was in then-Speaker Nancy Pelosi's office when then-Secretary Paulson came in to tell her that things were so bad with the economy, if we didn't act immediately, that our entire economy was going to implode.

So it just strikes me that to talk about not recovering quick enough, that the recovery hasn't been as robust as it should have, I don't think that that is particularly an honest assessment of what happened. We have not been in a situation as bad as we were on that point in our tenure here than the Great Depression.

So the fact that we have been able to bring back incredible private-sector job growth, the investments that we made in infrastructure—I have had companies in my district tell me, had it not been for the little bit of investment that we have given these people to repave streets and highways, they would have closed their businesses, they would have lost their businesses. That investment, I believe, was very worthwhile.

Now, fast forward to today, when we can see firsthand what a lack of investment in infrastructure is doing. Look at Flint, Michigan. The Ranking Member had to leave to go to a meeting on that. Children have been poisoned because we have not made the investments in infrastructure that we need to make. So not only did we lose the jobs and the economic growth that would have been brought about because of that investment, this is going to cost us dearly in the long run.

Also, the talk today about tax cuts and the fact that we are even discussing going down the road of passing more tax cuts that are unpaid for I think is frightful. The idea that we can just run up the debt, we should all be concerned about that. And Mr. Doggett mentioned it earlier. We have just gone through this. We passed a massive tax expenditure package that is going to add to our debt and is going to become a greater drag on our economy.

Now, like most of my colleagues here, I liked a lot of the tax policy that was in that package. As a matter of fact, a couple of the bills that I voted against were my bills because they—I voted against them because it was not paid for and the drag that would have on our economy.

And the last point I want to make is on the issue of employ stock ownership plans. I have a number of those in my district, and I have a number of other people who would like to get those going. I am particularly interested in the idea that it would reduce wealth inequality, as was referenced in your article, Mr. Bernstein. And I think it is a great way to move forward something positive. It doesn't cost us any money, doesn't add to the debt, puts more people to work.

And talk about looking into the eyes of your workers. The company Recology in my district, it is a municipal waste and recycling company. And when I go in to meet with them, they sit around

that conference table, and you have mechanics, you have truck drivers, you have recycle gatherers or picker-uppers, and they are just very, very proud of the fact that they own part of this company. And I think we could do a lot more to improve our economy.

So, Mr. Bernstein, I would appreciate hearing from you on those things.

Mr. BERNSTEIN. Well, I won't repeat my findings because you very much nailed them, so thank you for that. The only thing I would add is that the other thing I have found is that in companies that have employee stock ownership programs the wage distribution tends to be considerably more narrow than in companies that don't. So it is not just that they are providing their folks with some capital in terms of retirement security, but also paying them, typically, well also.

I have a couple of seconds. If it is okay, I would like to reference this discussion that just came up on the Affordable Care Act. And I am particularly interested in——

Mr. THOMPSON. I think we are going to repeal that again today, appropriately since——

Mr. BERNSTEIN. Well, that would be a huge mistake——

Mr. THOMPSON [continuing]. Today is Groundhog Day.

Mr. BERNSTEIN [continuing]. Based on the slides. First, just two things. I have 30 seconds.

One is, Steve's point that somehow there has been an increase in involuntary part-time work because of this 50-hours rule is directly contradicted by the data, which shows, in fact, part-time work—involuntary part-time work is what we would expect if people are being forced into part-time work—is falling sharply. And I show that in figures 4 and 5.

In figure 6, I show projections by the CBO that show savings of up to 3 percent of GDP based on costs of major health programs that have been——

Chairman BRADY. Thank you, Mr. Bernstein.

Mr. BERNSTEIN [continuing]. At least partly associated with the ACA.

Chairman BRADY. Thank you. All time has expired.

Mr. Paulsen, you are recognized.

Mr. PAULSEN. Thank you, Mr. Chairman. You know, this hearing couldn't come at a more critical time, a more important time. The testimony has actually been really sobering, but it has also been really, really instructive.

And it is true, when the President came in, we were in dire financial straits, a tough situation. But the fact remains, we have the worst economic recovery ever in the history of our country. We should be doing a lot better. The worst on record ever.

And it is no wonder, actually, 72 percent of Americans today still think we are in recession right now. Median household income has actually dropped for the first time ever, also, during an economic recovery. So paychecks have dropped, wages are flat. And it also took nearly 5 years just to get back to having the same number of people working again than when the recession first started in December 2007. That is the longest period of time to return to the starting point in any recession, actually, also in American history.

So, with that in mind, it is really critical, it is really important that we use every tool at our disposal—fixing a broken Tax Code, expanding markets overseas—to make sure that we are helping everyone achieve the American Dream and getting our economy back on track.

So I want to go back to some of these international tax reform points and why this is so critical, from my perspective, because you mentioned Medtronic, Mr. Moore, for instance, a Minnesota company. It is just one of many companies that we have heard of changing their headquarters, moving it overseas, for instance. Since 1982, my understanding is we have had 51 inversions, I think, that have taken place, but, actually, 20 of those inversions have happened since 2012. We have three in January of this month alone. And so the trend has accelerated.

And, actually, probably the real story is not the inversions but it is going to be the acquisitions of American companies by foreign competitors over time. And that is when you move the headquarters, you move the innovation, you move jobs overseas. So, in an iPod world, when you can move capital at the click of a mouse, we should be addressing this.

So my question is this. I will start with you, Mr. Moore. Do you believe that we should also look at doing international reform as a downpayment to the broader reforms that are needed, that are tough, that are challenging to get bipartisanly done, that we need for this Congress, but should we move forward on that, to making sure that we are addressing this competitiveness issue rather than a tax avoidance issue?

Mr. MOORE. You know, the thing that is remarkable about this issue is that, you know, when President Obama took office, he had a tax reform commission that was headed by Paul Volcker, who headed the Federal Reserve. And the Obama committee, or blue ribbon panel, basically said all the things that we are saying about the corporate tax: that it is chasing businesses and capital out of the country, that it is creating a competitive problem to the United States, and we ought to do something about this.

And that was back in—I don't remember the exact year, but it was 2009, 2010. It was certainly in President Obama's first term. Here we are 5 years later, and we are still having this conversation. Why haven't we done something about this? I mean, how many companies have to leave?

Now, look, maybe we have to have—I would favor just cutting the corporate rate right now to 15 percent. And, look, if we have to borrow to do it, do it, because that is going to bring jobs back to the United States.

But if you want pay-fors, I will just give you one example. I mean, one of the atrocious add-ons to the tax bill that you all passed last year was this indefensible credit for the solar industry. And we know what happened with that money. So you gave about a half a billion dollars to the solar industry, and we know what happened. All that money got capitalized into value of the shares of companies like SolarCity. So all you did was you spent \$500 million of taxpayer money to the shareholders of these companies. I mean, my goodness, how is that good tax policy?

Let's find those kinds of loopholes and credits, get rid of them, and get that rate, Mr. Chairman, down as low as we possibly can before more of these companies leave.

Mr. PAULSEN. Mr. Holtz-Eakin, some critics of moving to an exemption system for foreign earnings argue that it is some sort of zero-sum game and that any increase in investment abroad leads to a decrease in domestic investment here. You know, there is strong evidence that when American companies expand into foreign markets it helps the domestic economy.

Mr. HOLTZ-EAKIN. You are exactly right. I mean, the evidence is these are complementary, not zero-sum substitutes, that if you invest abroad, you expand your domestic employment investment as well. That is an important thing to remember.

I think there are other important things to just frame this issue. Right now, the discussion is entirely defensive. "How do we hold on to our companies?" We really should be on offense. We should want every company to locate here. We have some existing inbound investors, fully a fifth of our manufacturing base, and these are, you know, high-paying, good jobs. We want people to invest here. They are not going to do it if we remain the highest tax country in the developed world and retain our system of worldwide taxation.

The chart that Mr. Moore showed about the rate coming down is one thing. The second thing that has happened is, basically one a year, the OECD countries have moved away from worldwide taxation. We are the last ones left. So there must be some magic secret that we have hidden away in the West Wing that makes this a good idea when everyone else has given it up. And that is a place to worry.

I would also worry not just about the corporations but about the entrepreneurs tax through the passthroughs. One of the striking features of the recent data is the firm death rate for the first time has gone above the birth rate. We have seen the drop in firm startups be so dramatic that we are losing more firms than we are giving birth to.

I would worry about all the things that affect entrepreneurs. It is tax, it is trade, it is the regulatory burden. There is no single lever. But we have a problem in our business community.

Chairman BRADY. Thank you all. Time has expired.

Mr. Marchant, you are recognized.

Mr. MARCHANT. Thank you, Mr. Chairman.

When I go back to my district and have townhall meetings, the subject that comes up most frequently is the national debt. Whether it is young people, older people, people on Social Security, it is the inevitable subject that always comes up.

I would like all of your opinions, each of you to make a comment. What effect does the size of our national debt and the lack of a plan to reduce it have on our current economy? And what effect will it have on the ability of us to have a future growth economy? And let's just start with each panelist.

Mr. HOLTZ-EAKIN. So the current trajectory for the debt is unsustainable; it is explosive. That is bad for the economy right now, because if you are any rational investor from anywhere around the globe and you look at the U.S. and you say, okay, with-

in a decade we are going to get to the point where basically all borrowing is to pay interest on previous borrowing, that is a very dangerous place to put my money or hire my people.

Because only a couple things can happen: You can raise a lot of taxes. The terms on that are going to be low. You could not do something and end up in a big financial crisis, a sovereign debt crisis. That is a terrible growth strategy. Or you could get the budget under control with some sensible spending reforms, but that is only one of three things that is a good thing.

So it really damages the image of the United States as a place to start and to expand businesses. And that, I think, should be troubling to everyone right now.

We may stabilize the debt, but we are at a very high level. And if you do that, you are baking in a lack of flexibility in the budget, because you are paying a lot of interest costs every year that could be devoted to the annual appropriations or some other pressing national need. There is an inflexibility as a Nation; you are exposed to interest rate shocks, and you are going to have to manage that in a global economy.

So you give up a lot of the flexibility you would like to have, both as a budget entity and as a nation, by locking in at a high level. The best thing to do is to have a trajectory that stabilizes and then goes down, and that would be something that the committee should be looking for.

Mr. MARCHANT. Mr. Hassett.

Mr. HASSETT. I can be quick.

There is a big literature that suggests that when debt relative to GDP—this is just gross debt—gets above about 90 percent, then you get pretty slow growth. If you look at the forecast for the debt in the U.S., then it is easy to see about 1 percent lower growth every year because of the high debt that we have over the next 30, 40 years. And that is something that we need to get out in front of or we are going to have that low growth.

It is one of the reasons why, you know, 2 percent might actually be better than we can achieve. Because I don't think that those forecasts that we are looking at now that we are depressed about are fully incorporating the negative effects of the high debt.

Mr. BERNSTEIN. So I don't think the negative effects of the high debt are nearly as visible as Kevin's comments would suggest. For example, debt is high right now, and interest rates are very low, have been very low, and probably will be very low for a long time coming. So it is more complicated than that.

That said, I think Doug's point about the future is very well taken. And I don't think we are going to achieve a sustainable path unless we, and I guess I would argue you, accept that there is going to have to be spending cuts, which we have done a lot of already, but also revenue increases, which I think is just anathema to Members of this body. And we will never be able to achieve a sustainable path if people are unwilling to yield on that point.

Mr. MOORE. So I guess I am the outlier here. Look, the debt is a result of low growth. Low growth is not caused by the debt. If we get this economy growing at 3½ to 4 percent, where we should be, we are really not going to have to worry so much about the debt because the debt is going to fall both in terms of getting to a bal-

anced budget and also, what we care about, the debt as a share of GDP.

So I would urge you all to concentrate about what do we do to get growth up, because growth up will reduce the burden of the debt. I mean, Jared is right; we have the lowest interest rates in 50 years.

My problem with what we did in 2009 is not that we borrowed; it is just that we didn't get anything for the money. I mean, yeah, we borrowed a lot in the 1980s, but look what we got. We got tax rates down that caused one of the strongest expansions in the history of our country, and we defeated the Soviet Union, we won the cold war. That is a pretty good investment of \$2 trillion to do those two things.

I look at the economy now, and I look—we borrowed \$8 trillion in 7 years. What have we got to show for it? Solyndra? People on food stamps? People on unemployment benefits? I mean, there is just no lasting benefit to what happened when we did this.

And I just want to go back to this one quick point, that, look, people keep asking, "Gee, what if we hadn't done what we did? What if we didn't have the massive \$8 billion bill?" And we know what would have happened if we didn't, because this was a chart that was prepared. These were Jared Bernstein's own numbers. We have a higher unemployment rate than we would have had, according to Jared, if we hadn't borrowed all this money.

Chairman BRADY. Thank you. All time has expired.

Mr. Blumenauer, you are recognized.

Mr. BLUMENAUER. It has been so long, I forgot where the button is.

Thank you, Mr. Chairman. And I appreciate the diversity of opinions and the attitude that is being taken here this morning. I think this is important, and it has been useful.

I appreciate Mr. Bernstein's work on ESOPs. I am going to defer, I think, to my friend Mr. Kind, who might want to talk about it, but I think those are such a powerful tool to stimulate economic growth and to align the interests of workers and the corporation in a very powerful way.

I appreciated what we heard from Mr. Moore, talking about the 1986 spirit of cooperation and what happened in this committee with some disparate attitudes from people who—Reagan and Tip O'Neill. I would note that out of that compromise there was a significant increase in corporate tax rates, an increase in capital gains. There are some lessons there about the package that can be put together, and I hope we have a similar flexibility moving forward.

In particular, I would go back 4 years earlier, when Ronald Reagan and Tip O'Neill raised the gas tax a nickel a gallon, and we got some things for it. And that was done on a cooperative, bipartisan basis, raising a user fee, not raising the deficit.

I am hopeful that we might be able to exercise that same spirit of cooperation and bold thinking that isn't actually so bold—it is Eisenhower, it is Reagan, it didn't used to be controversial—in terms of the use of user fees rather than the gimmicks that we used this last year for—I am glad we have a 5-year reauthoriza-

tion. We have a little bit of money; we have 5 years of certainty. But it is not on a sustainable basis going forward.

I have shared with this committee before and I hope the committee, Mr. Chairman, might be able to at least spend a day looking at revisiting how we used to do it and listen to the broad consensus across interest groups—the U.S. Chamber of Commerce, the AFL-CIO, truckers and AAA, environmentalists, the people who are involved with road construction and other infrastructure—to look at something that is broadly agreed upon that would make a difference going forward.

And, frankly, I think we raise the gas tax to abolish the gas tax, because it is not sustainable, going forward, to base on gallons of fuel consumed to finance the underpinnings of our infrastructure.

And there is a better way. This committee has had legislation before it, which luckily got included in the reauthorization, to allow the pilot project that we have in Oregon to deal with road user charges that would be fairer, more sustainable, and would enable us to fine-tune the charge to be able to deal with things like congestion and maybe the lower costs in rural and small-town America. So it would be fairer, raise more money on a sustainable basis, and get rid of the gas tax, which is increasingly unrelated to road user benefit.

But my question—and, Jared, maybe you would like to comment. What impact would it have over the next decade if we took that spirit of Ronald Reagan and Tip O'Neill and raised the user fee in a sustainable fashion in terms of putting Americans to work at family-wage jobs across the country and having something to show for it

Mr. BERNSTEIN. Well, I will just reflect back to my comments to Mr. Marchant a second ago. I don't think there is a way forward that doesn't involve some compromise on this point. We can't achieve a sustainable budget simply by spending cuts. And, in fact, if you look at the nondefense discretionary side of the budget, where so much important spending goes on in issues like law enforcement, homeland security, education, research, public health, veterans medical care, that is slated to fall to its lowest share on record as a share of GDP by next year.

Mr. BLUMENAUER. Help me, Mr. Bernstein, on infrastructure.

Mr. BERNSTEIN. And so on—yes. So the tax on gas, on a gallon of gas, has been stuck at 18.4 cents in nominal terms since 1993. Now, in what kind of fantastical thinking can we pay for our roads, can we upgrade our roads on a tax that hasn't been updated in 20-plus years?

Chairman BRADY. Thank you. All time has expired.

Mr. Reed, you are recognized.

Mr. REED. Thank you, Mr. Chairman, and thank you to the witnesses.

Opening comment here, it has been interesting listening to the comments of my colleagues on the other side as well as the responses from the witnesses. And it is just ironic that I hear often about the glory days of the Clinton administration. The Clinton administration policies enacted a glorious budget surplus and economic growth, and that is all due to the Clinton administration. But yet when we talk about the Obama administration in this

present economy, of course, it can't be the Obama administration's policies that are causing this slow-growth economy. It has got to be all Bush No. 43, and we all blame it on prior—on Bush. So I think what we are hearing here is a lot of rhetoric, a lot of politics. You know what? I am sick and tired of that.

What I am interested in is some real solutions from this panel as we go forward with some reforms that we all know need to be done. Obviously, we have a broken Tax Code. The Tax Code has to be fixed. I see that there is potentially a road ahead for us to do that, but is there something to be done in 2016 in regards to comprehensive tax reform? I am always the eternal optimist, but let's be realistic and maybe we downsize our expectations here a little bit and focus on something maybe we can do, and that is international tax reform. As we deal with international tax reform, we have had some conversations with the White House. We have had some conversations with folks on the other side of the aisle and other side of the Chamber in the Senate about a real need to fix this issue. And I think we all agree that that problem is in need of fixing, and I think there is a bipartisan, bicameral effort to potentially tackle this, but one of my concerns—and I am a strong voice for U.S. manufacturing. I am a strong voice for U.S. manufacturing. I do believe we can make it here to sell it around the world again. That is something I have adopted in my office, and I firmly believe that opportunity is before us. And so as we go through, we look at U.S. manufacturing, what two-thirds of our U.S. manufacturers on a pass-through status, being taxed on the individual side of the coin. I am interested, a sincere interest, from the panelists, as we do international tax reform and as we look at potential reforms on that front with our international corporate entities in particular, what can we be doing at the same time in a 2016 horizon that you guys could potentially offer us in regards to those pass-through entities, the two-thirds of the U.S. manufacturers that are in need of tax reform just as much as the international tax component of the Tax Code that is in need of fixing?

Is there anything, Mr. Moore, that you could offer? And then we will just go right down—

Mr. MOORE. Well, it is a great question. I mean, look, you are right. Most of our companies are small businesses, and they pass this through—and medium-sized businesses. So there is some thought about, you know, if we are going to cut the corporate tax, we should cut the tax on small businesses at the same rate. I am in agreement with that. I just think the emergency is so great on our corporate system, that I just want to get it done right now. That is my—and let's deal with that issue later. And that is sort of the way I feel about tax reform generally. I mean, there is nobody—I have devoted 30 years to this issue of tax reform, so there is no one who wants it more with more urgency than I do, but I think we have got an emergency right now—we have talked about this all morning—about getting that corporate tax—and, look, to the Democrats in this room, yes, we as Republicans are going to have to give up some of the things that we want to get this done.

I mean, we are not saying it has to be our way, but this was done, Mr. Rangel. You know it. You were here in this room when it got done. And I loved what you said, by the way, in your opening



statement. I mean, I think you and the chairman should get together for lunch and figure this stuff out. Maybe you do need to talk more because I agree with almost everything that you said.

Mr. REED. Well, Steve, reclaiming my time, but I am really looking at, how can we take care of potentially an immediate concern that the pass-throughs, the U.S. manufacturers, the small businesses? Because one of the things I am concerned about is I come from rural western New York, and we have got a lot of people. And I go back to my home district. I am here on behalf of them. And I understand the concern on the international side, and we need to fix it. I join in that effort, but I want to do something for them, and I want to do something for them right now.

So what can we do, Mr. Bernstein—

Mr. BERNSTEIN. So I won't talk about this, but the strong dollar is making life very hard for our manufacturers, and—

Mr. REED. I agree with you.

Mr. BERNSTEIN [continuing]. I take your point about the inherent competitiveness. Instead of fighting over every one of the hundred tax deductions and expenditures in the Tax Code, I am all about closing the loopholes. We should limit those deductions and expenditures to 28 percent instead of the top rate of 40 percent. I think that would both improve efficiency, again, shut down subsidies and loopholes, and raise half a trillion dollars over 10 years.

Mr. REED. Mr. Hassett.

Mr. HASSETT. You know, I think that something that you guys could do this year would be just to—you know, Mr. Rangel, you said that we have got this high corporate tax, but none of the guys are paying it. You should experiment. If you cut the rate by 2 or 3 percentage points, you are not going to lose revenue. It is going to help American business. It is going to help American manufacturing. And the pass-through entities would see the rate reduction and change corporate form. It costs a couple of hundred bucks—

Mr. REED. Do it across the board, rate reduction for everybody.

Mr. HASSETT. Yeah.

Mr. REED. My time has expired. Thank you.

Chairman BRADY. Thank you.

Mr. Pascrell, you are recognized.

Mr. PASCRELL. Mr. Chairman, I listened very carefully to your introductory remarks, and you touched upon what we would be doing in terms of tax reform and welfare reform and health reform and trade expansion. And then I heard a lot of numbers go this way and then a lot of numbers come this way, and I said to myself, well, we have had smart people there like yourself before who said pretty much the similar, same kinds of stuff: How come we can't get this done? And my contention is that it has very little to do with the numbers because we all can make a case. We are all good lawyers when it comes to it, even though we are not lawyers all of us. You know, we need fact checks upon ourselves. We need fact checks. All of these scholars, I think they are good people. I have heard them testify, most of them, before. They have got a lot to say, a lot of good things to say. But you take the case of the threshold—since you are talking about the future and the economy—the threshold of the Affordable Care Act of 50 employees, you know, let's take that as an example. In 2014, 2014 alone, the number of

workers employed part-time for economic reasons declined by more than 1 million. The greatest increase in involuntary part-time work came in 2008, and Obama was not the President, was not the President.

So you painted—my good friend, Mr. Holtz-Eakin, you have painted a beautiful picture of the apocalypse; apocalypse II, it is all going to come down on us. I mean, maybe you are preparing us for the next recession, which you should be doing, part of your job, I think, but I think you need fact checks. You need them, and we need them. And then we could come to a conclusion together.

We are not going to do—we have so many redos since we passed plan D and prescription drugs. Talk about the economy. It is not a major part of this big picture that we are dealing with—what is the future budget going to look like?—but it is a good thing to go back to. Democrats lost on that issue, if you remember. We lost at 3 o'clock in the morning, 4 o'clock in the morning. We lost on the issue. We campaigned against it. I went to senior citizens to tell them to—I had to tell senior citizens why I am going to vote against this thing, even though it is going to maybe help them with their prescription drugs, pay for them. And then we found out what had happened in that 3:30, 4 o'clock in the morning and what it meant. Now, I didn't go back to my constituents, I didn't go back to my constituents and tell them: We lost, but we are going to fight this now.

No. I went back to my constituents and said: I fought the good fight, and we lost. Now we are going to have to make this situation work.

When has that happened in the past 8 years? When have you come forward with anything good to say about the economy? You would think—you know, we got—we have employed more people than all of the European countries put together since this great recession, depression, call it whatever the heck you want to call it. When have you ever come forward and said, "Housing is better now than it was in 2007, building new housing"? When have you ever—I have never heard it from the other side, and a lot of these guys and gals are my friends. I have never heard it from them, ever. Why? He did some good. We have done some good. And we have done the best when we work together.

So you can have all the numbers you want. You can have all the numbers to present, et cetera, et cetera. And I—you know, on page 11 in your report to us—Jared, you said something about the carried interest, and I think it is like a little mirror to this whole mess, carried interest, about how unfair that is when you are trying to deal with the economy, when you are trying to have fairness woven into the process, how important that would be, what the results of that would—that is, what, \$16 billion over 10 years, and it is not going to change the history of mankind, but it is just one example. Why can't we even get to that, when I know there are people on the other side that want the same thing we want? So when we are talking about budgets and future budgets, we are talking about not only numbers; we are talking about attitudes and altitudes.

Chairman BRADY. Thank you, Mr. Pascrell.

Mr. PASCRELL. You are welcome.

Chairman BRADY. Your time has expired.

Mr. Kind, you are recognized.

Mr. KIND. I thank the chair's courtesy. The dais kind of bends over here, and I get tucked away a little bit, but I want to thank the witnesses for your testimony here today.

And, Mr. Bernstein, let me start with you and just pick up on a line that Mr. Thompson was questioning you about. And I want to commend you for the recent article that you wrote on ESOPs, entitled "Employee Ownership, ESOPs, Wealth, and Wages." I believe for a long time that can be a tool when it comes to addressing income inequality.

Representative Reichert and I have had this ESOP modernization bill pending before this committee.

Mr. Chairman, I think that would be a very nice vehicle for us as a committee to move forward on. It doesn't cost anything. It makes it easier to convert to the ESOP model. I have visited a lot of the ESOP shops in my congressional district and throughout the State. And, you know, the pride of ownership, the productivity, the loyalty, all these factors coming into play, so I commend you for the article.

And I would ask unanimous consent, Mr. Chairman, at this time to have that article included in the record.

Chairman BRADY. Without objection.

[The information follows:]

## Employee Ownership, ESOPs, Wealth, And Wages

By: Jared Bernstein

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This report was commissioned by the Employee-Owned S Corporations of America. The author is solely responsible for the content. Any views expressed here represent only the views of the author.

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### Introduction

The growing problem of economic inequality has many different dimensions. The dispersion of economic outcomes has increased in the distributions of wages, incomes, and wealth. In earlier work, I've linked these developments to the potential for greater skewing of political power and influence, steeper barriers to opportunity for the many on the wrong side of the inequality divide, and even macro-economic disruptions.<sup>1</sup> In this paper, I begin by examining one important development in the increase of inequality: the shift in national income from compensation to profits. I highlight this aspect of inequality's growth because I am interested in the extent to which a particular policy might help to rebalance this recent shift in income types. That policy is employee ownership programs in general and employee stock ownership plans, or ESOPs, in particular.

Using a number of datasets and referencing a growing literature on this question, I show that shared ownership and ESOPs appear to have a small, equalizing impact on wealth and wage distributions. Since ESOPs transfer capital ownership to workers less likely to own capital, this equalizing impact is expected. But there is no obvious reason why wage distributions in firms with employee ownership should be less varied (more equal) than in other firms. Yet, while the data are only suggestive on this point, I show that as the extent of employee ownership rises, wage inequality among worker-owners declines.

Based on these findings, I also hypothesize that were such employee ownership plans to proliferate, their impact on inequality reduction could well be significant. In part, I argue that this is a result of transferring wealth in the form of stock in their companies to workers who, because they own little such wealth, reside in the lower reaches of the wealth distribution. But the result also flows from research, which I both cite and contribute to herein, showing workers do not appear to trade off one form of income, like wages, for ownership shares.

**The format of the paper:** Section one of the paper explains the theory of "factor incomes"—the division of national income noted above—and tracks recent trends. Measurement issues loom large here as various data series show somewhat different results. That said, they all show a significant shift from wages to profits in recent years. The next

section reviews the literature on ESOPs, including recent work on ESOPs' impact on jobs and firm-level productivity. An important finding of this review, one present in numerous studies, is that firms with ESOPs appear uniquely resilient in recessions relative to non-ESOP firms, perhaps due to enhanced cooperation by employee-owners. A subsection then examines ESOPs' utility as a policy tool to push back against inequality, with an emphasis on wealth inequality.

The next section uses the National Bureau of Economic Research (NBER) dataset on employee-ownership for analysis of ESOPs' impact on wage inequality. Though this dataset is very rich, it is not nationally representative.

However, I show that among firms with employee-owners a) wages tend to be more narrowly distributed (i.e., there is less wage inequality), b) that effect is positively correlated with shared ownership (as ownership intensity goes up, wage inequality goes down), and c) these firms have tighter wage distributions than what exists in the overall economy (though this finding depends on a rough comparison between the NBER dataset and a nationally representative dataset).

Following this empirical work, I consider the policy implications of the findings. First, I place ESOPs in context with various other policies that are intended to reduce inequality, like minimum wages or job creation policies. I argue that ESOPs can reduce both wealth and wage inequality. Given the importance of amplifying those effects through wider use of employee ownership, some may conclude that further tax incentives to promote ownership are warranted. I generally do not think so, but I suggest a few other policy ideas that could help ESOPs proliferate.

One important part of the ESOP research that I do not explore in this paper is their positive impact on a serious American economic problem that also relates to the growth of inequality: retirement insecurity. Because of the shift away from defined benefit pension, along with wage and income stagnation, a growing share of workers nearing retirement do not have enough saved to maintain their living standards in retirement.<sup>2</sup> Phillip Swagel and Robert Carroll point out that nearly 60 percent of American workers have no assets in a work-related retirement plan. ESOPs are an important part of the solution to this problem, and firms

with ESOPs have been found to contribute not just to the ESOP but to 401(k) plans as well, an important diversification point to which I return later. But my focus for this paper is on the impact of ESOPs and other employee ownership plans on various dimensions of economic inequality.

#### The Logic of ESOPs and inequality reduction

Before proceeding, let me explicitly draw out the logic behind this work. Broadly speaking, there are at least two ways middle- and low-wage working people who have been losing ground to inequality can dampen or reverse that trend. One, they can increase their earnings relative to higher earners, and two, they can accumulate a larger share of their firms' profits. The latter mechanism "works" (reduces inequality) because profit holdings are considerably more concentrated than that of earnings. Note, for example, that while about 20 percent of income is held by the top 1 percent of households, about 40 percent of wealth is held by the top 1 percent.<sup>3</sup>

So, when a lower-income person claims a larger share of a type of income that's more unequally distributed, inequality is "mechanically" reduced. The findings throughout this paper suggest that ESOPs and other employee ownership programs have this effect, though data suggest the magnitude of the effect is still small in part because ESOP ownership is still small, perhaps accruing to less than 10 percent of the workforce. Still, these findings suggest that growing employee ownership is a step in an equalizing direction, and thus more widespread employee ownership will increase the anti-inequality impacts documented below.

While I believe this logic is entirely sound, it is unfortunately the case that data limitations abound in this work such that neither I nor any other researcher (as far as I know) has been able to establish the magnitude of this effect (i.e. to quantify the equalizing impact of much more widespread employee ownership). There is, for example, no nationally representative dataset with information on these dimensions of inequality along with information on firms with ESOPs, for example. As noted above, I do use the very rich (though not nationally representative) NBER dataset with extensive information on

employee ownership and ESOPs. Scholars, most notably Blasi, Freeman, and Kruse (BFK, hereafter), have deeply tapped this dataset in their work on "shared capitalism," work I cite throughout.

#### Factor incomes: the shift from labor to capital and how ESOPs can increase the share of workers with capital ownership.

In national income accounting, there are two ways to decompose aggregate income. The most common is to look at Gross Domestic Product (GDP) from its production sources: consumption, investment, government spending, and net exports. But equivalently, GDP can be attributed to the different income-generating sectors: workers' compensation, profits to capital holdings, government income (through taxes and other fees), and proprietors income.<sup>4</sup> National accountants think of these sectors as different factors of income production. Workers generate value which returns compensation to them, assets spin off incomes to their owners, and so on (proprietors get their own line in the accounts because it's hard to know how to divide, for example, a lawyer's private practice into her compensation versus her profits).

To bring the analysis closer to a level that's relevant for this paper, Exhibit 1 shows a construct that's roughly private factor incomes, including compensation, profits, and proprietors' income in 2015q3. About two-thirds of the total \$14 trillion is compensation, with profits at 22 percent.

**Exhibit 1: Private factor shares of national income, 2015 Q3**

| Category     | Dollars (bns) | Share (%) |
|--------------|---------------|-----------|
| Compensation | \$9,736       | 68%       |
| Profits      | \$3,230       | 22%       |
| Proprietors  | \$1,403       | 10%       |
| Total        | \$14,368      | 100%      |

Note: Profits include rental income and net interest payments.

Source: NIPA Accounts

What matters more for our inequality analysis is how these incomes are distributed throughout the income scale. Most workers depend on their paychecks (compensation), and the ownership of corporate profits tends to be concentrated among the wealthy, as shown below. In fact, this simple insight motivates much of what is to follow: *ESOPs can be* thought of as a way to distribute profitability to those who largely depend on compensation. Given that profitability has grown faster in recent years than many workers' paychecks, the potentially equalizing impact of ESOPs motivates this research.

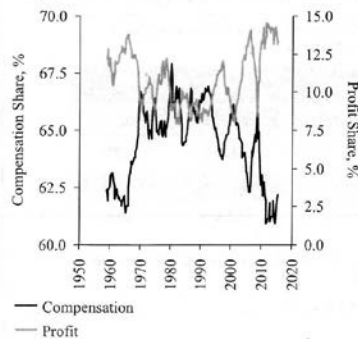
**The distribution of factor incomes:** In order to further motivate the research question herein, it is useful to try to learn more about the distribution of factor incomes, specifically wages and profits. While it is difficult to show the precise distribution of factor incomes, we can approximate their distribution in a variety of ways. The two important observations from the perspective of this report is that, unsurprisingly, profits are more concentrated among the wealthy than compensation, and that concentration has increased.

- The first look at the evolution of factor incomes is simply a plot of compensation and profits as a share of national income (Exhibit 2). Economists

are typically taught that compensation generally varies narrowly around about two-thirds of national income. That's a plausible estimate from around 1970; in fact, the average of the series since 1959 is 64 percent. But since the Great Recession that began in late 2007, the compensation share fell to historically low levels and vice versa for that of profits. Assuming that profits are disproportionately held by wealthy households, by this metric, factor incomes have become significantly more unequally distributed in recent years.

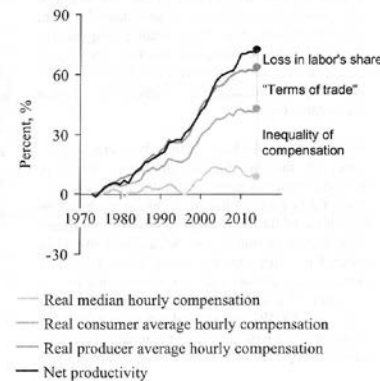
- Next, in Exhibit 3, economists Larry Mishel and Josh Bivens provide a useful decomposition of another relevant measure of rising inequality: *the gap between median compensation and net productivity growth* (productivity growth net of depreciation). Between 1973 and 2014, productivity is up 72 percent while real median compensation is only up about 9 percent, a difference of 63 percentage points. The modal factor implicated in this gap is the inequality of compensation, or in the terminology of this section, the growth of inequality within the labor income factor share. A smaller share—9 percentage points—is due to the loss of labor's share of national income (i.e., a shift from labor to capital, or profit-based, income).<sup>5</sup>

**Exhibit 2: Share of national income to compensation vs. profits**



Source: Bureau of Economic Analysis

**Exhibit 3: Percent Change in productivity and compensation from 1948**

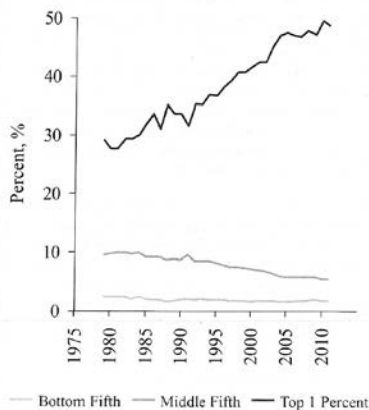


Source: Economic Policy Institute

An important lesson here relative to later analysis in this paper is that while ESOPs can increase the wealth of those who depend mostly on paychecks, equalization within the labor share remains a dominant source of inequality and a driving force behind the gap between wage and productivity growth. This should not at all detract from tapping employee ownership to help rebalance the shift between factor shares. To the contrary, wage results I show later suggest that ESOP firms have narrower (less-unequal) wage distributions than non-ESOP firms, and wage inequality tends to fall with the increased modes of employee ownership. But it will take both shifts between and within labor and capital factor shares to significantly reverse the many-decades long trend toward greater economic inequality.

- I noted above that data on the distribution of corporate profits throughout the household income distribution is scarce. One source, however, is the Congressional Budget Office's income series. In order to determine how they should allocate corporate tax liability to households, the CBO calculates what share of corporate (and labor) income goes to each income class. As Exhibit 4 shows, for example, the share of corporate income (analogous to

Exhibit 4: Distribution of corporate income

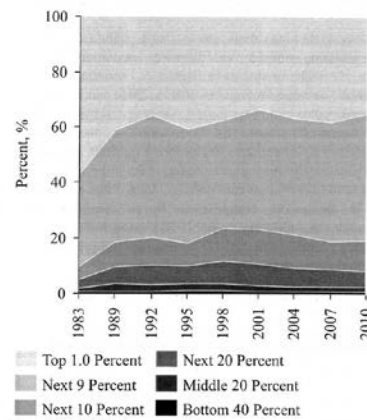


Source: Congressional Budget Office

the profit share in Exhibit 2) is skewed to the top 1 percent of households sorted by income. Moreover, their share of such holdings has increased from about 30 percent in 1979 to 50 percent in 2011. Meanwhile, the middle-class share has declined from about 10 percent to 5.5 percent, and low-income families have never held much at all of this income source.

- Finally, economist Ed Wolff has calculated *stock* market holdings by income class. While we hear more about the "democratization of the stock market" these days, that notion is driven by the fact that more people hold any stock now than in the past. But if we look at the value of stock ownership, we see it remains highly concentrated, far more so than income, for example. About 80 percent of the values of the stock market is held by the wealthiest 10 percent of households, while middle and low-wealth families hold amounts that are barely visible in the Exhibit.

Exhibit 5: Share of total stock value by wealth group



Source: Wolff (2012)



#### The direct effect of redistributing wealth: a simple simulation

Given these findings, I can now assert a point that is at the core of the research that follows: the direct effect of redistributing wealth to wage earners should be expected to lower income inequality. The connection to ESOPs is straightforward, and stems from the evidence just presented. To the extent the ESOPs provide stock market wealth to wage earners, inequality is likely to decline. Of course, "by how much?" is a relevant question to which I can only shed a little light, as significant data limitations exist.

What is the meaning of "direct effect" in the above assertion? Suppose there are indirect effects of ESOP provision, most notably, a dollar from an ESOP gets traded off with a dollar from wages. Then inequality is less likely to be reduced, and equally importantly, workers are not better off, and given the "time value of money" (a dollar today is worth more than a dollar tomorrow), arguably worse off. In this regard, the question of substitution, discussed at some length below, looms large in this analysis (importantly, analysts do not find such a tradeoff in the data on ESOPs).

To break this idea down into a simple, albeit unrealistic, presentation, consider the following simulation, the results of which are shown in Exhibit 6. I took the Census Bureau's average income by fifth in 2014, and broke the income values into two sources: earnings and wealth.<sup>6</sup> For the bottom 60 percent (first three quintiles), income is assumed to be all earnings, for the fourth quintile, income is 80 percent earnings and for the top fifth, 40 percent earnings (and thus 60 percent wealth). Again, these are not at all the true income compositions, but just a simplification to make the following point. I did design the shares to roughly replicate the 2/3, 1/3 compensation/profits in the national factor shares.

**Exhibit 6: Simulating how redistributing wealth lowers inequality**

| Actual | Wealth | Earnings |
|--------|--------|----------|
| 3.6%   | 4.8%   | 4.9%     |
| 9.2%   | 10.3%  | 10.4%    |
| 15.1%  | 16.2%  | 16.3%    |
| 23.2%  | 21.5%  | 21.3%    |
| 48.9%  | 47.2%  | 47.0%    |

Note: See text for simulation explanation

Source: Census

I then redistributed 10 percent of wealth and 10 percent of earnings from the top two quintiles to the bottom three. The resulting incomes shares are in Exhibit 6. By design, shares go up in the bottom three fifth relative to the top two—there's no income growth in this simple exercise, just redistribution. But even while the earnings share is about twice that of the wealth share (2/3 to 1/3), the equalizing impact of the redistributions is similar, because wealth is more concentrated than earnings. In fact, as suggested in the figures above, it is a lot more concentrated than in my simulation.

So, absent substitution effects, we should expect ESOPs to be equalizing. After a brief review of ESOPs in general, the following few sections examine this expectation.

#### A brief review of shared capitalism and ESOPs

Before turning to the literature on ESOPs and inequality, it is useful for contextual purposes to briefly describe ESOPs and their prevalence. ESOPs are defined contribution plans where the contributions are typically shares of stock in the employee's company. They are thus both a tax-favored savings vehicle (I'll explain the tax advantages below) and a form of employee ownership.

According to the latest data from the National Center for Employee Ownership (an advocacy organization for employee ownership), about 6,800 companies had ESOPs covering 15 million workers, about 10 percent of 2015 employment. According to NCEO, "In an ESOP, a company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares. Alternatively, the ESOP can borrow money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan. Regardless of how the plan acquires stock, company contributions to the trust are tax-deductible, within certain limits."<sup>7</sup>

Shares in the trust are allocated to employees based on measures such as relative pay or seniority, a fact that becomes germane in inequality discussions that follow. Unlike most other tax-favored employee savings plans, companies can add to their ESOPs by borrowing cash to buy company shares from the market (if the company is public) or from existing owners in privately held firms. The company can then make tax deductible contributions to the ESOP to repay the loan. In other words, companies finance their ESOPs with pretax contributions.<sup>8</sup>

There are many other ways the tax code favors ESOPs, though there are some distinctions based on the structure of the company (i.e., whether it is "C" or an "S" corporation). For example, once the ESOP owns 30% of all the shares in a "C corp," a seller of the stock can defer capital gains taxes by rolling over the gains into other securities. This advantage is not available to "S corps." However, NCEO reports that "the percentage of ownership held by the ESOP is not subject to income tax at the federal level (and usually the state level as well). That means, for instance, that there is no income tax on 30% of the profits of an S corporation with an ESOP holding 30% of the stock, and no income tax at all on the profits of an S corporation wholly owned by its ESOP." Towards the end of this report, I further explore ESOP tax from the perspective of incentives designed to generate more widespread employee ownership.

As with other employer contribution plans, employee owners of ESOP shares do not pay tax on ESOP contributions made by the company as they accumulate and appreciate during the employees tenure with the company. Upon cashing out in retirement, former employees pay income taxes at regular rates, again, like a traditional IRA. Moreover, employees can roll over their distributions in an IRA or other retirement plan, though any distribution would invoke capital gains taxation. When employees leave the company, their stock holdings must be bought by the company at either current market price, or, for privately held firms, fair market value determined by outside valuation.

Of course, ESOPs are just one option within a growing menu of shared capitalism vehicles.

#### **What does the literature show about ESOPs' impact on work?**

There now exists a body of research on the impact of "shared ownership" programs, meaning policies that provide employees with some share of the profits or ownership in the company that employs them. These include ESOPs (and variations, like KSOPs and S ESOPs<sup>9</sup>), profit sharing, gain sharing (e.g., a bonus to a group of employees that hit or surpassed a production target), or stock options. According to data from nationally representative General Social Survey, almost half of full-time, private sector employees (47 percent) participate in some kind of shared ownership program.<sup>10</sup> Many of those workers participate in more than one of these types of programs: 40 percent are profit or gain sharing plans, 21 percent participate in stock ownership in

their companies, and 10 percent receive stock options; 12 percent participate in all three forms of ownership.

ESOPs as a solution to the principal/agent problem: While the more recent research is branching out into new questions, as I'll show in a moment, historically, the main question asked by researchers is, "What impact have such programs had on company performance, including profits and productivity?" Intuitively, one might expect employee ownership to create a new incentive to work harder since the employee/owner now has some skin in the game. In terms of the microeconomics of the firm, ownership programs present a solution to the well-known "principal/agent" problem – the idea that in a typical business with no employee ownership, the incentives of the workforce do not align with that of the owners. Absent some way to realign incentives, the concern is that agents (non-owners) will not always act in the best interest of the principals (owners).

Studies that have asked the question posed above have generally answered, "yes, but..." where the "but" is some other condition that interacts with ownership programs in ways that improve the outcome variable, such as firm-level productivity. Typically, that condition is some process by which employee-owners can have an impact on the way the firm carries out its mission. These studies talk about the importance of giving workers "greater autonomy in decision making," a "supportive corporate culture," or a "participatory company culture."

Such findings make good common sense for two reasons. First, having "skin in the game" is unlikely, by itself, to solve the principal/agent problem. In order to tap the full potential benefits in terms of outcome measures for the firm, employee-owners need some way of providing input into the production process that goes beyond their own personal effort. Second, there's the "free-rider," or shirking, problem.

ESOPs and the free-rider problem: While employee ownership provides skin-in-the-game that helps to solve the principal/agent problem, it may also be the case that even when they're part owners, some employees may be contented to kick back and let others do the hard work. Especially when ownership shares are small, their preferences could be such that the benefits of any extra effort they'd need to contribute to boost productivity and profits are not worth the costs to them, especially if they see others

around them already trying harder. Such shirkers would be content to “free ride” on their more diligent co-workers.

However, the research reveals that when the “participatory company culture” extends to co-workers monitoring each other, such shirking is much diminished. According to BFK, “being part of a team, having a high participation in decisions, being treated with respect by supervisors, having formal training and job security, and being paid relatively well,” were all positively correlated with worker co-monitoring. Interestingly, these effects were negatively correlated with firm size, meaning workers in smaller firms were more likely to confront free riders.<sup>11</sup> This may reflect the fact that in larger firms, shirking is diluted – a few shirkers are not as damaging to the bottom line as when those few represent a significant share of the firm’s workforce.

BFK provide an interesting example of these dynamics at work as the result of a natural experiment that they were able to observe. A firm they were working with was about to introduce new profit-sharing plan, so the researchers were able to administer before and after surveys. They found that after the (generous) plan was introduced, “the percent of workers who said they were very likely to talk to a worker who was not performing his or her job properly increased from 42 percent to 55 percent.” Moreover, survey evidence suggested that this behavior was motivated by the concern that the shirkers’ behavior would diminish the profit share or stock price.

*Is there a tradeoff between ESOPs and base pay?:* While these research results regarding shared ownership are interesting and at least tangentially related to the questions of interest in this study regarding such programs’ impact on inequality, this next question is directly relevant: when employees participate in shared ownership, do they take an offsetting cut in their base pay? Regarding inequality and the technical discussion above, this possibility is of obvious importance because if employees are simply trading off one type of pay for another, the likelihood of any impact at all on inequality is surely diminished. Moreover, based on the economic theory of risk aversion, many such employees would in fact be made worse off by this exchange: substituting a certain form of compensation for a variable form is generally viewed as undesirable, even if on average, the paycheck is the same. That is, most workers find that greater variance around a stable mean generates greater economic insecurity.

Some earlier work on this question suggested a tradeoff might be in play. Robert Buchele et al (2010) point out that union members in industries that deregulated in the 1970s and 80s “made large wage concessions in return for ownership shares to save their companies and their jobs.” They also note that it is not uncommon for high-tech startups and even more established ventures to lure talent with stock options versus above-market pay rates.

But according to research that looks at a larger and more contemporary sample of firms, such cases are exceptions. The more representative work finds what I would describe as the “good employer package” at work: firms that offer shared ownership also pay higher compensation, including other retirement plans, such as defined benefit or defined contribution (note that the latter implies portfolio diversification away from just company stock). Using the rich NBER data set developed to analyze a broad spectrum of issues around employee ownership, Buchele et al run a revealing set of regressions on this question of offsets. Along with a variety of controls in an equation with base and total pay as the dependent variables, their key regressor is the value of the employee’s accrued stock per year of tenure relative to their base pay (note that this is simply the annual change in the value of their stock relative to their pay).

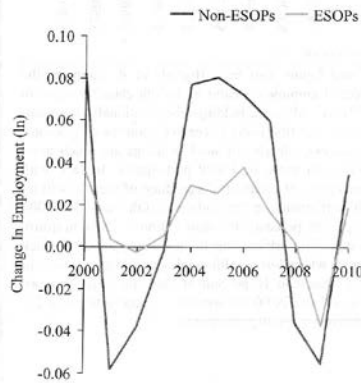
While the offset hypothesis would predict a negative coefficient on this variable, the researchers instead found positive coefficients across multiple specifications. In 12 of 14 equations, that coefficient was positive, in six it was positive and statistically significant, and in the two cases where the coefficient was negative, it was far from significant. Usefully, the researchers undertake a similar regression with a different data set (the General Social Survey, or GSS) and get similar results. Based on these findings, it seems considerably more likely that employers that offer shared ownership also offer better pay and benefits than a tradeoff between ownership and base pay. This is an important finding for my work in that it underscores the possibility that ESOPs reduce income inequality.

*Do ESOPs outperform other firms in recessions?:* Another relevant strain of new research on the impacts of employee ownership is work that asks how these firms perform relative to others in recessions. Are firms with shared ownership more stable vessels when the ocean gets rough, perhaps because the sailors have a great sense of ownership of the boat, or are they indistinguishable from the other ships in the fleet? Kurtulus and Kruse (forthcoming),

for example, ask if ownership firms have more stable employment in downturns. In the face of demand shocks, are they less likely than non-ownership firms to lay workers off? Through these authors' earlier work did not include the very severe demand shock that began in late 2007, often referred to as the Great Recession, their more recent update, cited below, includes data through 2010.

In fact, they find that employee ownership firms had higher survival rates during 1999-2010, and such firms were 80 percent as likely as non-EO firms to disappear, and 70 percent as likely to experience bankruptcy or liquidation. As Exhibit 7 reveals, these firms had more stable employment during the downturn, and Kurtulus and Kruse note that these results held even when the negative shocks hit the firms' sales and share prices. Another convincing aspect of this relationship between employee ownership and some degree of insulation from recession (relative to non-ownership firms) was along the "intensive" margin: firms with deeper employee ownership were more stable than firms with less.

**Exhibit 7: Change in employment for ESOPs vs. other firms (natural log of employment change)**



Source: Kurtulus and Kruse

While the authors have not yet been able to nail down the specific ways in which ownership firms weather storms better than those without, one intriguing hypothesis is that there may be something about the more cooperative culture in these firms that helps in this regard. Perhaps wages are more flexible, such that employee ownership firms can adjust to a negative sales shock, for example, along the wage versus the employment margin. In addition, firms with ownership programs may provide "greater employment security as part of an overall effort to build a more cooperative workplace culture," a culture which "can increase worker effort and general willingness on the part of workers to make adjustments during times of economic distress, which can increase firm productivity and lower the firm's need to lay off workers during financial distress."

A number of papers have examined this question of the relative performance of ESOP firms with a specific focus on S ESOPs. Analyzing data on 49 firms with S ESOPs during the severe downturn in 2008, Swagel and Carroll find that while overall payroll employment contracted by about 3 percent that year, employment in these firms rose by 2 percent. Remarkably, considering the massive collapse of the housing bubble in that period, the authors find this same pattern existed in construction employment, where S ESOP construction firms actually added jobs that year while overall construction payrolls cratered by 10 percent. Research on S ESOPs by Alex Brill underscores these findings, showing significantly faster than average job growth by ESOPs in the 2000s, particularly in manufacturing, another industry that struggled in those years.<sup>12</sup>

Again, little research has been conducted on why ESOP companies appear to be so much more resilient, even in particularly harsh recessions, but along with more cooperative culture, another factor could be that these companies are financially more secure. Data compiled by NCEO shows that employee-owned businesses have fewer loan defaults than other businesses, with an average default rate on bank loans to ESOP companies of only 0.2 percent between 2009 and 2013. By contrast, mid-market companies in the U.S. typically default on comparable loans at an annual rate of 2 to 3.75 percent. NCEO argues that the difference is related to incentives of employee-owners much like those cited by Kurtulus et al. That may well be so, but my point here is that given the destructive role played by excessive leverage in the last downturn, their low loan default rates suggests ESOP companies were less likely to

catch the unsustainable borrowing fever that plagued other businesses (and households).

#### Employee ownership, ESOPs, and the distribution of wealth

As per information discussed so far in this study, we know two relevant facts regarding the distribution of wealth, or net worth, in the U.S. First, it is highly concentrated, as shown in exhibits above regarding corporate income or the value of the stock market. Second, certain employee ownership programs, ESOPs in particular, distribute shares of stocks to those in income classes that are less likely to hold stock. Thus, also as suggested above (recall the redistributive simulation), we should expect that ESOPs are at least somewhat equalizing.

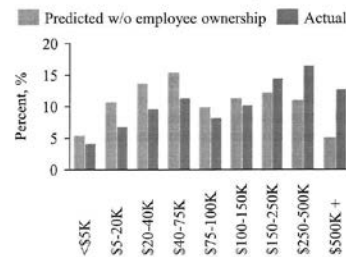
There are, however, two reasons why “somewhat” might not amount to very much, i.e., why we shouldn’t expect ESOPs as they stand today to significantly equalize the highly skewed wealth distribution. First, the distribution of ESOPs tends to reflect the distribution of earnings, as shares of company stock tend to be granted proportionally to salaries, a practice which mechanically links earnings inequality with wealth inequality. Still, since earnings is less concentrated than wealth, we should at least expect ESOPs to be equalizing in sign if not of great magnitudes.

Second, ESOPs remain a relatively small part of wealth, either in the aggregate or even among those who hold them. About 10 percent of the workforce participates in ESOPs, and their holdings tend to be relatively small, though accumulation matters: those who’ve been in ownership plans for years have a lot more to show for it than newcomers.<sup>13</sup> NCEO reports that ESOP company filings for 2008 showed that the average participant received above \$4,400 per year in company contributions and had an account balance of \$55,836. It’s also the case that ESOP holders tend to hold other forms of wealth, typically through other tax-favored retirement vehicles like 401(k)’s, though comparisons show ESOP balances to be more than twice as large as 401(k) plans.<sup>14</sup> From the important perspective of diversification, the fact that company stock tends not to be an ESOP participants’ sole holding is of course a feature, not a bug.

Despite these constraints, it is not hard to show the equalizing impact of ESOPs on the wealth distribution. The exhibit below, from Buchele et al, uses data on wealth hold-

ings and employee ownership to model the distribution of workers by wealth class with and without the benefits of ownership shares. If ownership had no impact on the distribution of wealth, we’d expect the bars to be of equal height, i.e., workers would be distributed similarly through the wealth classes. However, the actual distribution (the darker blue bars) is more skewed to the right—toward higher wealth holdings—than the green bars. Clearly, by this metric, employee ownership shifts its beneficiaries into higher wealth classes.

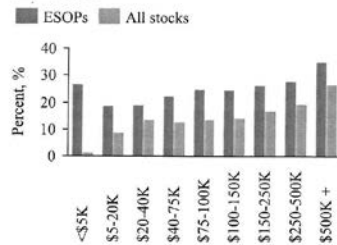
**Exhibit 8: Distribution of workers by wealth class**



Source: Buchele et al

The next figure, also from Buchele et al, compares the percent of employee wealth by wealth class for those in ESOPs with all stock holdings for a nationally representative data set (the Federal Reserve’s Survey of Consumer Finances). Clearly, all stock holdings are much more skewed than those of ESOP participants. In fact, with the exception of relatively large share of wealth held by ESOP participants in the highest wealth class (\$500,000 and up)—35 percent—the distribution is fairly uniform. This stands in stark contrast to the distribution of all stock holdings, where low wealth employees have very little in stocks—less than 10 percent of their holdings for those with less than \$20,000 in wealth—compared to about 20-25 percent for ESOP participants.

**Exhibit 9: Percent of employee's wealth in ESOPs and all stocks**



Source: Buchele et al

Buchele et al present a rough estimate of the extent to which ESOPs reduce wealth concentration. They show that the share of wealth (netting out any liabilities, so this is "net worth") of employees with ESOPs is 58.5 percent for those in the top 10 percent of the wealth distribution and 4 percent for those in the bottom 40 percent. When they recalculate those shares taking out the value of employer stock, those shares go to 61 percent for the wealthiest 10 percent and 3 percent for the bottom 40 percent. The differences in these shares can be attributed to equalizing impact of ESOPs. Thus, ESOPs reduced the concentration of high-end wealth by 2.5 percentage points, and low-end wealth by one percentage point.

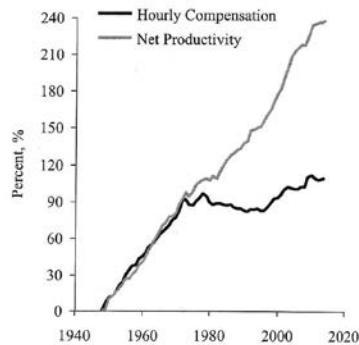
Finally, diversification concerns are obviously relevant and history is replete with example of employees hurt by owning too much company stock relative to other holdings. Empirically, however, research suggests that ESOP companies are more likely to also set up 401(k) accounts, and that these accounts tend to be diversified, often because companies provide investment advice to achieve that outcome. Rosen points out that "ESOP companies are slightly more likely to have a secondary retirement plan (even a defined benefit plan) than non-ESOP companies are to have just one plan."<sup>14</sup> He also points out that "mature" ESOP plans engage in their own diversification. ESOP participants 55 and up with at least 10 years in the plan "can diversify up to 25 percent of their company stock. Five years after they start doing this, they can diversify up to 50 percent."

#### More on ESOPs and wage inequality

While I had hoped in this paper to be able to map ESOP ownership onto a nationally representative data set and thus be able to evaluate its impact on distributional outcomes, data limitations have thus far prohibited such a matching exercise.

However, I can explore another important dimension of inequality, that of wages. Increased dispersion of wages has been a fundamental characteristic of growing inequality since the mid-1970s. One of the most compelling pictures of that development is in the next exhibit, showing the growing wedge between the real compensation of middle-wage workers and productivity (real output-per-hour) growth. Between 1948 and 1973, both productivity and middle earnings almost doubled; both grew more than 90 percent. Since then, productivity is up 72 percent and compensation for middle-wage workers is up only 9 percent, a huge difference in trend. Clearly, middle and low-wage workers are benefitting much less from the growth in output, growth to which they themselves are contributing.

**Exhibit 10: Percent Change in productivity and compensation from 1948**



Source: Economic Policy Institute

The reasons for this split are beyond my scope in this paper. As I've written extensively elsewhere, they relate to the absence of full employment, persistent trade deficits, growing educational differentials (the growing wage advantage of those with more education relative to those with less), the rise of finance, the erosion of labor standards and unions, and generally speaking, the weak bargaining clout of many in the workforce.<sup>16</sup> Here, much like in prior sections that reflected on the role of shared ownership opportunities, especially ESOPs, in wealth inequality, I'd like to reflect on that role in the context of wage inequality.

I've already cited research showing there does not appear to be a wage tradeoff in exchange for benefits of ESOPs, profit sharing, etc. But to what extent do firms that offer shared ownership also push back on wage inequality? One might hypothesize that shared ownership firms operate a bit more from the "we're-in-this-together" playbook and thus support pay scales with less dispersion than other firms. In this section, I examine that hypothesis as best I can given data limitations.

Here again, the lack of a nationally representative dataset with information on benefits such as ESOPs et al is a constraint. However, the NBER dataset used to great effect by many authors cited above (and at the core of the work by BFK) offers a potentially useful way to look at the question. This data set, designed to investigate many dimensions of firms that offer the full spate of shared ownership programs, has data on over 40,000 workers at such firms. For my purposes, the key variable is their base pay, controlling for a wide variety of factors, including worker characteristics and exposure to what BFK call "shared capitalism." In this regard, their "shared capitalism index" (SCI), which measures the extent of such offerings at the firm level, is a key control in what follows.

The downside of the NBER dataset is that while it is incredibly rich in information on firms that practice shared ownership, these are the only firms in the dataset. Thus, it is far from representative of the universe of firms, and offers little by way of opportunity to compare employee ownership firms with firms that do not offer such benefits. However, we can make a few revealing comparisons. For example, we can look at the difference in wage inequality between firms based on their different degrees of intensity on the SCI. Also, while it is a very rough comparison, one I would not put a lot of emphasis on, I can also compare the wage distribution in the NBER dataset to that of a nation-

ally representative dataset (the Census Bureau's Annual Social and Economic Supplement).

Exhibit 11 features the metric "log variance" (lv) to measure wage inequality. As its name suggests, this scalar is simply the variance of the natural log of earnings, such that higher lv's imply more wage dispersion or inequality. Each entry in the table presents the lv for a different sample, with the basic sample comprised of all observations where the worker is based in the US (since firms in the NBER dataset can be multinational, workers can reside outside the US), at least 18 years old, and works full-time (more than 35 hours per week). The other columns add other sample restrictions. "SCI=0," for example, means a value on the shared capitalism index of 1-10; "ESOP" means the worker's firm has an ESOP (typically, as emphasized in the literature, such firms offer other programs as well). "Prof share" indicates a firm with (at least) profit sharing, and so on. "Basic sample, ASEC" is the lv from the national representative Census data set noted above, with the same controls of the basic sample for the NBER dataset.<sup>17</sup>

**Exhibit 11: Log variances for different samples**

| Sample         | Log Variance |
|----------------|--------------|
| Basic          | 0.313        |
| SCI > 0        | 0.300        |
| SCI > 5        | 0.190        |
| SCI = 1        | 0.206        |
| SCI = 10       | 0.118        |
| ESOP           | 0.256        |
| Profit Sharing | 0.314        |
| 401(k)         | 0.314        |
| Stock Options  | 0.315        |
| Basic, ASEC    | 0.486        |

See text for details

The results generally, though not always, follow the expected pattern. Increased intensity of shared capitalism lowers the lv, though SCI=1 has an unexpectedly low value, implying less wage dispersion than I hypothesized (I take a closer look at this finding in a moment). Firms with extensive shared benefits have extremely tight wage distributions in the NBER dataset, with an lv of 0.118, less than

half that of the basic sample. The presence of an ESOP lowers the  $I_v$  relative to the base sample; at 0.256, firms with ESOPs have less wage inequality than those with the other types featured in the table. The representative distribution from the Census ASEC is considerably higher than the basic sample from the NBER data, but unfortunately, these are apple and orange comparisons, as the sampling frameworks are so different. However, the difference is suggestive and motivates further work in this area, as I discuss in the conclusion.

One shortcoming of Exhibit 11 is a lack of controls. Exhibit 12 shows coefficients on the SCI from various specifications with the log of yearly earnings as the dependent variable. The hypothesis again is that as SCI goes up, pay does as well, in this case, with an extensive set of controls, including fixed effects for companies and year, education, gender, age (and age squared), and tenure. Using OLS, the SCI coefficient is about 0.05, implying that a 1-notch move up on the index of ownership intensity corresponds to a 5 percent increase in pay, equivalent to about \$3,000 in these data. Again, this confirms a point made throughout the literature regarding the complementarity (versus substitutability of base pay of employee ownership programs).

**Exhibit 12: Coefficients on SC index (dependent variable: log earnings)**

|                             |        |
|-----------------------------|--------|
| OLS                         | 0.0516 |
| <b>Quantile Regressions</b> |        |
| 10 <sup>th</sup>            | 0.0580 |
| 30 <sup>th</sup>            | 0.0540 |
| 50 <sup>th</sup>            | 0.0501 |
| 70 <sup>th</sup>            | 0.0474 |
| 90 <sup>th</sup>            | 0.0460 |

Note: All coefficients significant at the  $< 0.001$  level.

See text for details

But to get at the distributional question, I run "quantile regressions" (also in Exhibit 12) which, broadly speaking, return the SCI coefficient for different classes of earners. Interestingly, the coefficients on SCI decline as the percentile on which the regression is centered goes up, implying larger earnings gains from shared capitalism intensity as for lower relative to higher earners. While the gradient is consistent, the differences are relatively small; still,

the pattern suggests an equalizing impact from employee-ownership.

As ESOP scholar Joseph Blasi points out, these results finding tighter wage distributions in ownership firms may be related to the finding, quite common in this literature (as discussed above), that ESOP firms tend to be more productive, all else equal. Blasi suggests that it may be the case that in non-ESOP firms, the primary way to get ahead is competing internally to "climb the ladder" in ways that may or may not improve the firm's output and efficiency. ESOP firms, which tend to be less hierarchical with more shared rewards, can benefit from "promotions" from their shares, gains, profit shares, etc. By dampening "wasteful" (in efficiency terms) internal competition—"managing up" as it is called in the business literature, meaning pleasing managers rather than boosting the bottom line—ESOPs' tighter wage distributions may in themselves be productivity enhancing.

More broadly, this theme suggests a negative relationship between inequality, particularly internal wage distributions, and productivity. Exploring this connection is beyond my scope, but there is a burgeoning literature on linkages between inequality and macroeconomic variables, notably productivity growth, which has slowed somewhat alarmingly in recent years. The connection Blasi suggests is worthy of further study, in no small part because the opposite could be true as well. That is, if the gains to climbing the hierarchy are outsized due to high internal earnings inequality, and the firm accurately promotes, i.e., promotions are for marginal increases in productivity, not wasteful competition, this effect could go the other way, towards higher firm-level productivity.

#### Where do ESOPs fit in an anti-inequality policy framework?

As discussed in the introduction, since there are many different types of incomes, each with its own unique distribution, there are many different types of economic inequality. In this section I briefly note the various types of inequality through the prism of policies designed to push back on the extent of inequality. I then place ESOPs within that framework.

Inequality analysts generally focus on three dimensions of inequality: that of wealth, income, and wages. Of course, these are related, but they are also usefully disaggregated. Wealth tends to be more of a stock variable, one that both



generates income flows, through interest payments or asset realization, for example, while income is a flow variable, driven higher or lower by labor earnings (wages), transfers, taxes, flows from wealth, and so on. Wages themselves are a function of hourly pay along with labor supply, including hours worked per week and weeks worked per year.

While this disaggregated typology may seem overwrought, there are at least two reasons why it is useful. First, though inequality is up in all three variables—wealth, wages, and incomes—there are markedly different trends and levels in all of these variables. As noted earlier, the wealth share of the top 1 percent is about twice that of the income share (about 40 compared to 20 percent). While low and middle-wage men's wages have generally been stagnant in real terms for decades, family income has gone up more quickly due in part to greater labor supply, particularly by women, whose wage trends have been more favorable than men's, at least up until around 2000 (income for poor families has also been boosted by increased government transfers).<sup>18</sup> Second, because of such differences, a broad set of policies are needed to address the increase in economic inequality, as different policies target different aspects of growing inequality.

The minimum wage, for example, has been shown to be a useful policy to reduce the gap between low and middle wages, particularly for women.<sup>19</sup> But "high-end inequality," that among the top 1 percent of income or wealth, is far beyond the reach of the minimum wage. In my own work, I have documented the inequality-reducing impact throughout the wage distribution of full employment, providing support for macroeconomic policies that achieve that goal. I have also stressed the impact of trade policy (and persistent trade deficits) on production worker/blue collar jobs and earnings.<sup>20</sup>

Based on the literature and findings above, ESOPs fit into this mix in two ways. Uniquely, they appear to push back on two different types of inequality, and they do so directly and indirectly. First, recall the income simulation above, showing that since wealth holdings are particularly concentrated among high-wealth families, and profits such as return on capital ownership, like equities, are part of wealth, a policy that transfers wealth to wage earners will tend to reduce wealth inequality. In fact, the research cited above by Buchele et al found a reduction in wealth concentration among the top 10 percent of employees with ESOPs by 2.5 percentage points. This is the direct impact

of wealth redistribution through employee ownership of their companies. BFK, arguably the nation's top experts on the economic impacts of employee ownership, underscore this point in arguing that the "best way...to break the trend toward greater inequality and to direct our society away from the road to economic feudalism is to increase the citizens' share of the business capital in this country."

In assessing Buchele et al's findings and BFK's strongly positive assertion, it is important to remember that many workers hold a variety of different forms of employee ownership (this was the source of the variation in the SCI from the previous section). BFK report that about a third of all workers hold some combination of ownership vehicles: 12 percent of all workers are employee-owners and profit sharers; 4 percent share of profits and get stock options; 5 percent are employee owners and get stock options; 12 percent hold all three (ownership, profit sharing, stock options). Based on the fact that these forms of wealth are among the most concentrated, I would score these somewhat diverse ownership shares as further evidence of the more direct form of direct, equalizing redistribution.

Another direct, equalizing force in play is that by dint of ERISA rules, ESOPs may not grant stock to wage earners above a cap, a policy in place to ensure that the firm's ownership distributions meet the ERISA condition that the most highly compensated employees do not receive such a large share of the benefits that lower paid workers would be egregiously left behind. In 2016, eligible pay for ESOP allocations goes up to \$265,000 per year, to be indexed for inflation in \$5,000 increments in subsequent years.<sup>21</sup> This cap not only restricts employee ownership for those with compensation levels over the cap. It may create some pressure to tighten the wage distribution relative to non-ESOP firms, leading to the findings in Exhibits 11 and 12 above, i.e., the indirect equalizing effect I discuss next.

The indirect way ESOPs and employee ownership in general appear to reduce inequality is shown in the wage analysis in the previous section, suggesting that the wage inequality is lower in ownership firms, and that the distribution becomes less unequal as the extent of ownership within firms rises. This finding also holds based on a rough comparison with a nationally representative data set of all workers' earnings. Moreover, this gradient (less wage inequality with more ownership) persists even when I add extensive controls to the sample. This is an indirect outcome and simply suggests that for unknown reasons,

firms that offer employee ownership tend to have tighter wage distributions as employee ownership rises (or, to be more accurate, firms in the NBER dataset). It is not, like the wealth impact, a "mechanical" outcome of transferring wealth to a group with less of it.

How far could these relationships be pushed? If we were somehow able to significantly increase ESOP participation, would wealth and wage inequality be significantly reduced? As we often say in answer to this sort of question in economics when our data and knowledge are just not "there yet," we can be certain of the sign, but not the magnitude. I particularly have little doubt that a more widely shared distribution of firm ownership and business capital through ESOPs would further reduce wealth inequality. As Kruse points out, the only way that would not happen would be if ESOPs substituted for wages, and this is something we clearly do not see in the data.

There is, however, a limiting factor in play here that current data do reveal. While I suspect, based on analysis above, that there is less pay inequality within ESOP firms, there is still an unequal distribution of wages therein. Since ESOP contributions are usually made as a percent of earnings, the reduction in wealth inequality within ESOP firms will be limited by the amount of pay inequality. As noted, wealth is considerably less equitably distributed than wages, so if ESOPs helped push wealth inequality to look more like wage inequality, that would be a solid step towards less overall inequality. And, if earnings distributions are, as my findings suggest, less unequal in ESOP/ownership firms than non-ownership firms, this too would push in a more equitable direction. But quantifying these impacts is at this point well beyond available data.

#### ESOPs and tax policy

Given the above findings and speculations regarding inequality, some will argue that progressive policy should include tax incentives, such as those discussed earlier in the paper, to increase ESOPs. As noted above, like most retirement savings vehicles, ESOPs already receive favorable tax treatment. In this section, I briefly return to the tax benefits of ESOPs and argue that they are sufficient. Especially given the importance of maintaining (and increasing) government revenue in order to support other equalizing policies, like improved learning opportunities for those facing educational access barriers, adding even more tax incentives around ESOPs or other type of em-

ployee ownership may yield negative net benefits.

Unique among retirement savings vehicles, companies with ESOPs can borrow to buy newly-issued company stock. Those shares then become tax-deductible contributions to the ESOP. As bankers at Wells Fargo point out, "[b]y borrowing money through an ESOP, the company can raise cash and deduct both the principal and interest payments on the ESOP loan." Moreover, as noted earlier, when an owner of a C corp sells at least 30 percent of their firm to their workforce, they can avoid capital gains taxes on the sale if they rollover the proceeds into other securities (this deferral ends upon a subsequent sale of the gains). Advocates for ESOPs correctly note that this tax deferral provides owners with a strong incentive to set up ESOPs, and thus argue that the capital gains deferral should apply to S corp ESOPs as well.

However, S corps have some of their own special tax privileges associated with ESOPs. S corp earnings are passed through to individual shareholders, and when the sole shareholder of an S corp is an ESOP (i.e., the ESOP own 100 percent of the company) taxes on company earnings are deferred until distribution, helping to build up retirement assets considerably faster than would otherwise occur. Once retirees cash out of the ESOP, they must pay federal taxes at their income tax rates. While this is a valuable tax break for employee owners, it does not create an incentive to set up an S-ESOP, as does the gains deferral break for C corp owners.

Given ESOPs' equalizing effects, from a social welfare perspective, these tax incentives are arguably worthwhile. Moreover, this view gets further some support by comparing ESOPs' impact on inequality to that of 401(k)'s, where the benefits flow largely to those at the top of the income scale. Marr et al show, for example, that most of the benefits of 401(k)'s—about two-thirds—accrue to those in the top fifth of the income scale, while those in the bottom fifth are the least prepared for retirement.<sup>22</sup> Should tax policy tilt further toward ESOPs and other more direct forms of employee ownership, like profit sharing? Should policies like the one proposed by presidential candidate Hillary Clinton—a tax credit equal to 15 percent of profits that businesses share with employees—get a closer look?

This is not an obvious conclusion. As tax expert Martin Sullivan reasonably points out, given their current spate of benefits, it's not clear why more employers need even

more incentives to take up shared ownership programs.<sup>23</sup> He writes, "Given the generally positive effects of profit sharing, [the Clinton credit] would not be the worst thing in our tax code. But so far, the Clinton campaign has not explained why smart employers taking into account all costs and benefits are not already providing profit-sharing plans in situations where they make sense."

#### A better idea to promote ESOP ownership

My suspicion, based not on research but on informal discussions with various businesses without ESOPs, is that the answer to the question Sullivan poses (if employee ownership is so great, why do we have to offer even more generous tax benefits than those that already exist?) has more to do with actual or perceived startup costs: managers perceive the process of setting up an ESOP as complex and costly. There is also some concern that their employees could become under-diversified.

In this regard, I agree with BFK, who have suggested a government function, housed perhaps in the Small Business Administration or the Commerce Department, that provides direct assistance, at no cost, to small businesses that want to set up ESOPs or other shared ownership plans.

Turning back to the tax code, another interesting idea is that businesses might be more likely to introduce profit sharing if other tax benefits that they currently enjoy, like bonus depreciation, deduction of the interest costs from debt financing, deferral of taxes of overseas earnings, or the ability to pass through business earnings to the individual side of the code, were conditional on setting up ESOPs, gain/profit sharing, and so on (the tax deferral on gains realized by C corp owners after selling their shares to an ESOP is an example of this idea in practice; extending it to S corp owners would be consistent with this suggestion). Instead of making these benefits automatic, why not, in the interest of both greater revenue collection and incentivizing more employee ownership, make them contingent on offering ownership shares to workers? Given the inequality findings above, this seems like a useful incentive to build into the tax code that has the potential to raise more revenue than under current law.

#### Conclusion

Inequality has grown among various dimensions in the American economy. Wealth, for example, is a lot more

concentrated, as shown in various exhibits above, and this has resulted in shifts in "factor incomes" from compensation to profits. Since ESOPs transfer wealth to workers—from owners to employees—a natural question is whether they can help push back on this trend in inequality.

Much of the literature reviewed above, including extensive work by BFK, suggests ESOPs can play that role. ESOPs have been shown to reduce wealth inequality, and my own analysis of the NBER dataset finds that firms with employee ownership programs tend to have less unequal wage distributions. Would a lot more ESOPs mean a lot less inequality? Based on the empirical patterns I and others identify, ESOPs' equalizing effects are limited by the fact that less than 10 percent of the workforce participate in them. Though the existing data do not allow researchers to quantify the impact of greater ESOP participation, my analysis suggests that more ESOPs would mean less inequality, probably of both wealth and wages.

I do not, however, believe that this finding should lead policy makers to further incentivize ESOPs through the tax code, at least not by offering new tax breaks, as the current state of tax advantages incentivizing employee ownership goes far enough, especially considering future revenue needs. I do, however, suggest two ideas for expanding ESOPs: a small government agency or bureau to help firms manage the process of starting an ESOP, and "reversing the polarity" of current business tax breaks to make them conditional on the firm having some form of employee ownership.

Future research in this area of ESOPs and inequality could be advanced by adding questions about the various forms of employee ownership on nationally representative economic surveys that collect information about income and wealth. Obviously, this would take resources, as these questions can quickly get complex. However, experts such as Doug Kruse, who was instrumental in creating the NBER dataset, have some field experience in asking questions about employee ownership. Even a one-time, point-in-time set of questions on a survey like the Federal Reserve's Survey of Consumer Finances would be useful in that it might allow a deeper look into the impact of ESOPs on inequality in America.

**Endnotes:**

1. See, for example, <http://talkingpointsmemo.com/features/marchtoinequality/deepdivaintoinequality/>.
2. [http://money.cnn.com/2010/03/09/pf/retirement\\_conference/](http://money.cnn.com/2010/03/09/pf/retirement_conference/)
3. To see this difference, compare figures 6 and 10 here <http://talkingpointsmemo.com/features/marchtoinequality/deepdivaintoinequality/>.
4. In the national accounts, this is called gross domestic income; it also includes consumption of fixed capital (income generated through depreciating capital).
5. "Terms of trade" is a technical factor derived from the fact that consumer prices grew faster over this period than producer prices.
6. That is, I simulated this combination. The underlying data do not provide such a breakdown.
7. <http://www.nceo.org/articles/esop-employee-stock-ownership-plan>
8. This pretax contribution privilege does not apply to ESOPs in S-corps.
9. ESOPs are a hybrid of 401(k) plans and ESOPs wherein companies match employee contributions with stock (S-ESOPs are ESOPs in S-corporations).
10. Blasi, Freeman, Kruse (2013), chapter 3.
11. BFK, pgs. 165-6.
12. <http://community-wealth.org/sites/default/files/downloads/paper-brill.pdf>
13. Recent NCEO data report 15 million participants in ESOPs; employment in 2015 was about 150 million, ergo the 10 percent cited in the text. BFK found, from the General Social Survey, that about 20 percent of private sector, full-time workers who are not self-employed have some amount of employee ownership in their company.
14. <http://esopplus.com/esop-vs-401k-which-type-plan-makes-better-retirement-plan/>
15. See <http://www.nceo.org/assets/pdf/articles/Do-ESOPs-Need-Reform-Rosen.pdf>.
16. See my latest book on this topic: <http://jaredbernsteinblog.com/wp-content/uploads/2015/12/PA-Updated.pdf>.
17. I also restricted the ASEC sample to those who worked at least 30 weeks a year and whose earnings were at least the same as the minimum in the NBER dataset, updated to 2014 dollars. I used sample weights to calculate the IV.
18. This increase in the post-transfer incomes of the poor is, however, partially a function of overvaluing publicly provided health care benefits. See <http://talkingpointsmemo.com/features/marchtoinequality/deepdivaintoinequality/>.
19. See, for example, <http://economics.mit.edu/files/3279>.
20. See Reconnection Agenda, Chapters 3 and 5. <http://jaredbernsteinblog.com/wp-content/uploads/2015/12/PA-Updated.pdf>
21. I thank Loren Rodgers, the executive director of the National Center for Employee Ownership, for this information.
22. <http://www.cbpp.org/research/retirement-tax-incentives-are-ripe-for-reform>
23. <http://www.forbes.com/sites/taxanalysts/2015/07/20/can-hillarys-plan-for-profit-sharing-boost-the-economy/>

Mr. KIND. Thank you.

And another point that some of my colleagues have raised too, and that is the eagerness—and it is a concern I share—it is the eagerness for this Congress to support tax cuts that aren't paid for and that are not offset and the potential damage it can do for our fiscal solvency as a Nation at a time when we have got 10,000 boomers retiring every day in this country and joining Social Security and Medicare. And I know politically it is one of the easiest votes to cast is a tax cut that is not paid for, but there are consequences to it.

We heard testimony earlier today from this panel talking about the beneficial effect of the Reagan tax cuts, but what was failed to be mentioned was the eight subsequent tax increases that followed that initial tax cut in order to deal with the exploding budget deficit that resulted from that decision.

There was also talk about the idyllic 1986 tax reform moment where there was bipartisan support for reducing individual rates, but what was failed to be mentioned was it also entailed one of the largest business tax increases in our Nation's history at the time to help pay for a lowering of those individual rates in that 1986 reform bill.

There has been testimony about what other nations are doing to lower their corporate rate, but what was failed to be mentioned is those same countries are dialing up their VAT in order to replace the lost revenue that they are experiencing from a reduction of the corporate rates. We don't have that luxury in this country, other than going after loopholes and expenditures within the Tax Code that we should be willing to go after and deal with that inefficiency in the Tax Code.

And yet last December, this Congress again passed an \$800 billion permanent tax change to the Code without a nickel of it being offset, and as Mr. Doggett pointed out, that is \$2 trillion over 20. And a few years ago, we had permanency of the Bush tax cuts, 95 percent of what was made permanent in the Tax Code. It is a multitrillion dollar expense that our country will be suffering because, again, that was not offset. And this administration shares some of that blame. They have given up more baseline revenue funding in their 8 years in office than any previous administration has to this date. Even the Bush administration sunset his tax cuts to 10 years in order to make the budget scenario look better, even though at the time, everyone kind of knew that once you do it, it is going to be permanent at some point in the future.

There is a cost, especially with the aging demographics of this Nation, that we are not addressing. And I just caution this committee to stop going down this road of delivering more tax goodies without any offsets, without any pay-fors. We have got to be more fiscally responsible for future generations than that.

And I am also—and I think someone else mentioned it, but also, we need to have more testimony, more hearing about the type of investments we have to be making in the human capital of this Nation, not just corporations, not just businesses, but human beings.

And, again, Mr. Bernstein, let me end it with you, and I want to thank you for the recent article you just published in the Washington Post about the missed opportunity of—

Mr. BERNSTEIN. You are reading all my stuff. I——

Mr. KIND. I am sorry, but it is jumping out at me for some reason, but——

Mr. BERNSTEIN. That is great.

Mr. KIND. If you want to, you know, pick that up just a little bit about that missed opportunity to——

Mr. BERNSTEIN. Absolutely. First of all, on the ESOPs, let me just make one point about employee stock ownership programs. I think the Tax Code actually incentivizes ESOPs plenty as it is. What I would actually do, and I have talked to numerous employers, you probably have too, who are interested in starting ESOPs, but don't see the way forward, don't understand how to do it, think it is complicated, think it is expensive. I have recommended an agency, a small agency within Commerce that helps people who want to do that, just give them advice, and I write about that in my piece.

Look, on investment in human capital, the piece I wrote yesterday that you are referring to talks about the return on investment in early childhood education. We can talk about early childhood, or we can talk about pre-K, quality pre-K. According to a really pretty careful analysis, Kevin talked about controlled studies, ideas where you look at the intervention on one group first that got the intervention, another group that didn't, we are talking about returns on investment that are as high as \$8.50 for every dollar invested when these kids grow up. We are leaving large amounts of benefits on the table here and a lot of kids behind.

Mr. KIND. Thank you, Mr. Chairman.

Chairman BRADY. Ms. Black, you are recognized.

Mrs. BLACK. Thank you, Mr. Chairman.

And I want to ask my question to Mr. Holtz-Eakin. Some say that the deficit and the debt are not a problem. And I hear that from people, and it just drives me crazy because if you were in your own household building up the kind of debt that you had in the deficit and looking, by the end of—at the end of the last year, our total debt passed that \$18 trillion mark. When I say this to my constituents, it is really hard to even fathom what that is because when I talk about trillions, it sounds almost like it is fictitious. The CBO now tells us that it is on track to reach \$29 trillion by 2026. We should all be concerned about this when we talk about the economy.

Do you think our growing debt is a threat to our economy?

Mr. HOLTZ-EAKIN. I do. That trajectory turned level and forward is unsustainable. Something has to change. And how it gets changed is the central question. The first question is sort of, what you do? Do you get the debt to go down, or do you just, you know, get it stabilized somehow? I would argue against stabilizing it because even now we are spending over \$200 billion a year on net interest with interest rates relatively low. Everyone on this committee can think of a good use of \$200 billion to meet national needs. So locking in high levels of debt locks in high commitments for interest and crowds out other budgetary activities and/or returning the money to the private sector.

The second issue is suppose you don't stabilize it, and then, you know, you have got even higher taxes. You know, you don't have

to be a raving supply-sider to recognize how dangerous that is. Again, deficit out there at the end of 10 years, \$1.3 trillion. Suppose you wanted to just close the deficit. Do we really want a trillion dollar tax increase to do that? So you are going to have to take on some combination of activities, or if you don't, you know, private enterprise, either domestically originated or looking in from outside, is going to say: This is an unappetizing place to do business; we are going to go elsewhere.

Mrs. BLACK. So if you had your way today, where would you say the first reform would be that we should start looking at to help to at least begin to solve this problem?

Mr. HOLTZ-EAKIN. So the sad reality is that it is going to have to be in the area of the entitlement programs because all the budgetary work that has been done to date in recent years has focused on the discretionary side. That has never been the problem, and I think recent history has suggested the caps that were written into the Budget Control Act were unrealistic. On two occasions already, the Congress has undone them.

So let us go to the real problem. The problem is mandatory spending programs: Social Security, Medicare and Medicaid, Affordable Care Act, go down the list. Many of those have a big demographic component so they are going to rise inexorably with the baby boom, so speed is of the essence. And, you know, all of them are going to require a lot of careful consideration on both sides of the aisle to get it done. I mean, so I hate to say it, you know, you got to go do entitlement reform, but you do, and it is going to be difficult, and doing it fast is important.

Mr. MOORE. Let me make a quick point on this.

Mrs. BLACK. Mr. Moore.

Mr. MOORE. I am, obviously, for the kinds of reforms that Doug is talking about, but the focus of this hearing was on, what can we do to improve the economic growth of the country? And Doug probably knows these numbers by heart better than I do, but let me put it simply. If we keep having 2 percent growth, you can't get from here to a balanced budget. You just can't. The numbers, it doesn't matter how much you cut; you are not going to get it to a balanced budget with 2 percent growth rate. We have to get to 3 to 4. And I think we actually, given that we have been in such a growth rut for such a long time, I don't see why we couldn't strive for 5 percent growth. If you do that—now, you probably know these numbers better than do I, Doug—every percentage point increase in growth over a decade is, what, another \$2 trillion or something?

Mr. HOLTZ-EAKIN. Every tenth of a percent is about \$300 billion.

Mr. MOORE. How much?

Mr. HOLTZ-EAKIN. If you get a whole percentage point, you could get \$3 trillion.

Mr. MOORE. So that is why this is such an important hearing. You know, we need to concentrate obviously on spending control, but we also have to get that growth rate up to at least 3.5 percent.

Mrs. BLACK. So that would be the second part of my question, actually, that you picked up on. In the growth, we can't just grow our way out of it. We do have to look on the spending side and—

Mr. MOORE. What I am saying is it is a precondition.

Mrs. BLACK. Absolutely.

Mr. MOORE. It is a necessary, but not sufficient.

Mrs. BLACK. And so the question on that, with my 35 seconds left, which we are not going to have an opportunity to discuss, is the whole issue of taxes. And as I tell people at my town hall meetings at home, if I can give you more money back in your pocket, what are you going to do with it? And, without exception, everybody in the room—mostly females, but the males also—say, I am going to spend it. And if you spend it, that increases the opportunity for another job. And if somebody has another job producing a product, that means that we are going to actually spend more money and bring in more revenue. So this whole thing about, well, reducing taxes really doesn't help, yes, it does because if I put a dollar back in your pocket, most people are going to say, "I am going to spend a dollar," which means production of another product.

So thank you, Mr. Chairman.

Chairman BRADY. Thank you.

Mr. Davis, you are recognized.

Mr. DAVIS. Thank you very much, Mr. Chairman.

Mr. Bernstein, you testified that our economy demonstrates solid labor market trends and that our entire poverty policies have helped reduce poverty over the past few decades. However, there remain groups of Americans who are not yet experiencing this economic recovery. For example, the University of Illinois, Chicago's Great Cities Institute, recently found that almost half of African-American men ages 20 to 24 in Chicago are neither in school or working. Alarming, this rate is higher than other racial and ethnic groups in Chicago and also is much higher than their peers in other large cities, such as Los Angeles and New York City.

Let me ask you, what policies would you think are needed to help strengthen the economic well-being of these Americans who are not yet benefiting from the economic recovery that we talk about?

Mr. BERNSTEIN. Well, thank you for asking that question and bringing it into this hearing, I think for the first time, a significant group of people who have been very much left behind. And these kinds of problems, deep disconnection from the overall economy, occur in neighborhoods across the country.

I think what would help them most directly would be a job saturation program where direct job creation combined with a human capital program to help these folks improve their skills would really deal with a fundamental problem in these areas, which is they are job deserts. Even when we are competing—even when we are increasing employment throughout the country, there are areas of the country that remain essentially deserts in terms of job creation, and there we have a market failure. And when the market fails, the public sector has to step in and make up the difference. And when I say "job saturation," I am not just talking about a job or two; I am thinking about a deep investment in direct employment opportunity coupled, again, with a human skills investment program as well.

Mr. DAVIS. Well, let me thank you for that. And I also believe that we can look at improving TANF in a way that might add another opportunity in terms of subsidizing some of the jobs that are



indeed created and also providing benefits to individuals who are childless, who don't necessarily have children, in terms of earned income tax credit and making use of that as a way of stimulating work for this group.

Mr. BERNSTEIN. Yeah. I very much agree with you. And by the way, no less than my colleague Doug Holtz-Eakin down there, who is on the other side of the aisle, who mentioned the importance of expanding the earned income tax credit to childless adults, something that I think there is some bipartisan support for.

In terms of TANF, you raise a really important point. Here is a program that was block granted back in 1996 and where welfare reform arguably had some positive results. What happened there was a real disinvestment in this program vis-à-vis helping some of the most disadvantaged families with children. Back in 1996, right at the point where welfare reform was passed, 68 percent of poor families with kids received some benefits from the program. Now that is just around 20 percent. Only 8 percent of TANF funding goes to the basic assistance with childcare and work activities of the type we have talked about. So we have to be very careful and not go down this block granting, or what Congressman Ryan calls opportunity grant program, where we really disinvest in precisely the kind of investments that the neighborhoods that we are talking about so desperately need.

Mr. DAVIS. And let me ask you quickly, there are still individuals suggesting that the Affordable Care Act is going to decrease jobs and work opportunity and eliminate jobs. Do you see any possible way that that happens as a result of the Affordable Care Act?

Mr. BERNSTEIN. Well, I can only speak about the data record on this, the empirical evidence, and the empirical evidence shows that anyone who is claiming the ACA is a, quote, "job killer"—you unfortunately hear those two words all too often—really has nothing to stand on. We have already talked about the job—the overall labor market improvement, which I think has been very strong, but I also pointed out that there has been no increase in involuntary part-time unemployment, as Steve's model would predict. In fact, quite the opposite, and at the same time, there has been a clear increase in healthcare employment.

Mr. DAVIS. Thank you very much.

I yield back, Mr. Chairman.

Chairman BRADY. Thank you.

Mr. Kelly, you are recognized.

Mr. KELLY. Thank you, Mr. Chairman.

I thank the panel for being here.

I heard one of my colleagues talk about being here when Mr. Paulsen came into the Leader's office and talked about the economic crisis. I remember that. I wasn't here. I was actually back in my dealership trying to figure out what the economic crisis meant to me because I had payroll to make. And there are many times—and most of us in the private sector have made sure that the people that work with us got paid, and we didn't get paid.

But today's panel and the discussion was about economic growth. And I know we get too political in these things, and we don't talk enough about policy. You all study that, and you know what is going to make a difference. And, Steve, I have listened to you, and

Mr. Bernstein, Mr. Hassett, Mr. Holtz-Eakin, I mean, I really wanted to hear from you today. I don't need any more stump speeches, quite frankly. I have lived it. And I spent more time on the blacktop than a laptop, so nobody has to tell me about theoretically how things happen.

When you put more money into the pockets of consumers, they spend it. That is what gets the economy going. People are not leaving this country because they hate it. They are leaving because it doesn't favor them anymore or offer them opportunity. That is ridiculous in America. And I am constantly concerned about it. And there was a cartoon I remember when I first came out of college that we had posted in the back office, and it said: The beatings will continue until morale improves.

And I think just put that into the private sector and then constantly be beat up every single day because of your greediness, the fact that you want to do something with your money that the government doesn't agree with.

So, Doug, between all of you, other than tax reform, and I am talking about complete tax reform, how are we going to grow our way out of this? There are opportunities all around the world. I would love to see us keep our base and then grow our opportunities. In a country that is awash in so many assets, the only thing missing right now is leadership to get us back to there. So if you can. There are only 3 minutes left, and I really appreciate you being here, but this is so basic. We should—this is like figuring out how many angels you can fit on the head of a pin. It is right in front of us how to fix it. We talked about energy. We talked about all the things we have going. Doug, and, please, and if you all can just go down through it. We have to get this fixed.

Mr. HOLTZ-EAKIN. Yes. And you have heard my list before. The one thing that hasn't been discussed that I would emphasize is genuinely taking on the regulatory burden imposed by the Federal Government. At the American Action Forum, we read and follow every regulation issued by the Federal Government. We take at face value the cost the agencies themselves generate for what it will take for a private businessman to comply with them. In the past, a little over 7 years, the agencies have issued a final regulation at the rate of over one per day, and the cumulative regulatory burden is over \$800 billion, as reported by the agencies themselves. That is basically \$100 billion a year in disguised taxes.

Mr. KELLY. Just real quickly, would you please, for people who don't understand this, where do all those costs get transferred to?

Mr. HOLTZ-EAKIN. They are going to show up as lower wages, higher prices, or people going out of business.

Mr. KELLY. Amen. It is the price on the shelf when you are all done. I don't care if it is taxes or regulation; it gets added on to the finished product or service, which makes it harder for people to consume it, which makes it harder for us to compete in the global economy. This is a Forrest Gump moment. There ain't no fixing stupid.

Mr. HOLTZ-EAKIN. So I would encourage everyone to take a look at that. You have a lot of oversight in this committee on places that issue some very expensive regs.

Mr. HASSETT. Mr. Kelly, here is one way to think about your question. Would you like to go to Greece right now and start a business? Well, you can think: Well, you know, there probably aren't a lot of people starting businesses in Greece, and so if I brought some capital there, maybe I could make some money. But if you look at how busted the government is, then you can more or less be sure that if you started to have a successful business, then at some point a few years from now, they are going to take it out of your hide with higher taxes, and so you don't go. You don't think—like none of us in this room are thinking: Hey, let's all go to Greece and start businesses. Their business formation is low, so it is a great opportunity for us. It is because you are looking at a country that is fundamentally broke. If you look at the CBO long-run outlook for the U.S., we look like Greece not that far from now. And so if you want to—

Mr. KELLY. A lot more zeroes.

Mr. HASSETT. So other than tax reform, what can we do to create growth? We need to make ourselves a place where people, you know, basically want to go there and start a business—

Mr. KELLY. Kind of like selling cars.

Mr. HASSETT [continuing]. Because they are optimistic about the future.

Mr. KELLY. Yeah. Yeah. It is kind of like selling cars. Right product, right—

Mr. BERNSTEIN. I am on the other side, but I have an issue—an argument you might like here, which is, what about a minimum tax on foreign earnings? If that was set at an adequate level, firms could repatriate their earnings without further U.S. taxation. That is an idea the administration has put forth. I think Dave Camp had that idea as well. So a minimum tax on foreign earnings, I think would help get around a lot of this nonsense.

Now I will argue with you very quickly, which is if you give a dollar to a very rich person, they won't spend it. So that has been shown time and again. They will save it. Now, that is not a bad thing, but I just want to correct the record on that point.

Mr. KELLY. Steve.

Mr. MOORE. Boy, you know, when I was at the Wall Street Journal, we used to talk to CEOs of the major American companies, you know, the great men and women who lead our companies, and, you know, the story of this half-baked recovery is this: businesses are making money. The stock market has done great over the last 5 or 6 years. It hasn't done so well recently, but it has been a huge—and that is because companies are profitable. And we would always ask these men and women, why—where the things have broken down in the economy is they are not reinvesting that money into the economy the way that they used to, at the rate that they used to. And we would always ask them—now this is just, you know, anecdotal—but almost every man and woman we talked to when we asked them, “why aren't you reinvesting,” they said they are afraid. And then we would ask them, what are you afraid of? And think of what they have lived through: ObamaCare, tax increases on the rich, you know, massive increases in debt. All of these things have just pounded businesses down, so they are in a kind of state of hibernation right now. They are not spending. We

need to get them to start spending and hiring again. And part of this is just attitudinal. Let's start treating businesses like they are good things rather than villains.

Chairman BRADY. Thank you. All time has expired.

Ms. Sánchez.

Ms. SANCHEZ. Thank you, Mr. Chairman, and thank you to our witnesses for joining us today. This hearing feels like it is becoming a perennial favorite, which I think is very fitting for Groundhog Day. The committee now gathers at the beginning of each calendar year for the Republicans to decry the terrible economic decisions made by President Obama that have supposedly sent this country spiraling into a bottomless pit, while the Democrats on the committee point out some hard facts, such as the following: 70 consecutive months of private sector job growth; 14.1 million jobs created; the longest consecutive private sector job growth in our Nation's history; 18 million people who now have health insurance after ACA implementation, many of them my constituents, by the way.

So here we are again for our annual meeting of what I like to call fact versus fiction. And I will at least give the majority credit for not inviting a witness here to testify today who submits overly sexist testimony like last year. At least that is a tiny step in the right direction.

But more to the topic at hand, do I think that our economy is perfect today? Absolutely not, but we are far from barreling off a mountain into oblivion. And I know that that is not popular with the panic merchants on our panel today who are peddling the narrative that "oh, my God, the sky is falling, the sky is falling."

I want to echo some of the sentiments made by many of my Democratic colleagues on the issue of wage stagnation in this country. Hard-working families are overdue for a well-earned raise, but I would note, again, just as I did at this same hearing last year, that there continues to be a whopping zero Republican cosponsors on the bill to raise our Federal minimum wage. And if Mrs. Black were here, I would like to ask her: How's that for putting a dollar in the pocket of a working person who would spend it? Let's think about raising the Federal minimum wage. What a novel concept.

We have a tremendous opportunity to improve the economic conditions for working people all across the country. And the eternal optimist in me, despite everything that I have heard today, isn't ready to throw in the towel yet on fighting to ensure that the improvements that we make to our economy are felt by everyone, not just those at the very, very, very, very, very top of the food chain.

Mr. Chairman, I know you have spoken a lot about your desire to focus much of this year on overdue international tax reform, but I hope that those efforts are not going to be done in a vacuum that forgets and disadvantages our domestic manufacturing sector because we need a level playing field in tax reform, and tackling this effort piecemeal is not the way to go, or we will harm our own manufacturers.

Finally, with the rest of my time, which is short, I would like to turn to one of the biggest potential economic benefits to this country, and that is the economic benefit of comprehensive immigration reform. And just for a refresher, immigrants in this country are people who invest back into our communities by purchasing things

like homes and school supplies, and starting businesses in many blighted areas. Half of the people who are living here in an undocumented status have been here for at least 10 years waiting patiently for a pathway to citizenship so that they can pay their fair share of taxes and contribute even more to our economy.

Our failure to act on comprehensive immigration reform means that we are effectively walking away from economic growth that could also help improve the long-term financial standing of our Social Security trust fund.

So in the last minute that I have left, Mr. Bernstein, given your policy expertise and your work, could you provide me with your thoughts on the issue of comprehensive immigration reform and why that isn't seriously being talked about today as a potential economic growth factor?

Mr. BERNSTEIN. I will not only do that, but I will tie in some of the other issues you raised, in your what I thought were just a great set of commonsense comments there.

By the way, I think you will find a lot of friends on this panel on the question of comprehensive immigration reform.

The idea that the economy—I mean, the fact that the economy is growing more slowly than we like—we all share that view—is partly constrained by labor supply. Labor supply is growing more slowly than it used to, and that is a very direct factor into economic growth. This is well-known. And, in fact, if you look at projections as to what is slowing the economy down, it is diminished labor supply is, even more so than slower productivity growth, the main culprit. So CIR, comprehensive reform, in that spirit would very much attenuate that constraint.

Now, if we are going to have more folks here, some of them are going to be low-income workers, disproportionately women, by the way, and therefore we need to raise the minimum wage as well as the good EITC ideas we have heard even from colleagues on the other side. I think—

Ms. SANCHEZ. And perhaps even closing the wage gap, but that is just my personal opinion. Continue.

Mr. BERNSTEIN. Absolutely. Comprehensive immigration reform in tandem with an enhanced EITC and a higher minimum wage makes a lot of sense to me.

Chairman BRADY. Thank you.

All time has expired.

Ms. SANCHEZ. Thank you, Mr. Chairman.

Chairman BRADY. You bet.

Mr. Renacci, you are recognized.

Mr. RENACCI. Thank you, Mr. Chairman.

I want to thank the witnesses. I apologize. I was away for a little bit of this listening to some budget issues, which I think are very important. Gives you a real good setup to come back here.

At the end of last year, our debt rose over \$18 trillion, and I know my colleague, Diane Black, talked about that, but that doesn't account for the \$42 trillion liability that is not on the books and something we never talk about.

When I was in the business world for almost three decades and I did a lot of turnarounds, first thing I did is I went into a troubled entity, and I determined what their balance sheet looks like. And

I am very frustrated that here in Washington, we like to talk about \$18 trillion. We never like to talk about the \$42 trillion additional dollars that really are unfunded liabilities, and, again, it will be part of the balance sheet.

So I would ask, maybe I will start with you, Mr. Holtz-Eakin, why is it important to take a look at the total picture, including those unfunded liabilities? Because I do believe—and I want to get back to later with Mr. Moore—there are two sides to this. We are talking about economic growth, the importance of economic growth. Well, the one thing you have to do is you have to look at your expenditures. The other thing you have to do is you look at how you can increase payroll and employment, but if we don't—and somebody talked about Greece, which I think is so important. People look at this country and say we are still the greatest country in the world, but as this debt continues to grow, are we a place to really come and build a business? And we have got to make sure that we are always competitive, but don't we have to look at all of the liabilities and really make our decisions based on that?

Mr. HOLTZ-EAKIN. Yes, you do and with the caveat that I don't like to refer to them as liabilities because they aren't the same as contracts that have to be honored. These are policy decisions that have been made in the past, should be rethought in the present, and have to look different in the future. But the reality is if you are sensible about looking at the commitments that are out there, add them up in a balance sheet style fashion, you know then one of two things. These are going to be the draws on the taxpayer to fulfill all those commitments, and that number is unthinkable; or these are going to be the kinds of commitments that are going to compete with national security and all the sort of basic functions of government that our Founders envisioned, basic research, infrastructure, education, those things. So, you know, take a look at those liabilities. Those are the entitlement programs, and make sure you see the scales of what they are going to impose on the rest of the economy.

Mr. RENACCI. And, in turn, we could also look at the decisions we make and how they affect all those liabilities.

Mr. HOLTZ-EAKIN. Of course. You should know the long-run implications of things you do right now.

Mr. RENACCI. Mr. Moore, do you have any comments in regards to a total balance sheet picture here as something to look at?

Mr. MOORE. It has always struck me, being any sort of budget expert in this town, that, as you just said, we don't do a balance sheet like a business does. I mean, it is sort of crazy that, you know, if we accounted like a business did, you know, we wouldn't pass any basic audit. So I like this idea of taking into account these long-term liabilities, but it is also important to remember that these liabilities are not baked in the cake. You know, nobody has a legal right to Social Security benefits. Nobody has a legal right to Medicare or these other things. You can change the benefits, and we ought to start looking at ways to change the benefits in ways that will reduce these long-time liabilities because they are not—you know, these \$50 trillion of liabilities you are talking about, that is fixable. That is fixable, but we should start right now before all 80 million baby boomers have retired.

Mr. RENACCI. Sure. If we have the political will——

Mr. MOORE. Right.

Mr. RENACCI [continuing]. They are fixable.

On the growth side, I just have a question for—and this, Mr. Bernstein, you even talked about this. If we took some of the dollars that were overseas and brought them back and were able to put them at a lower rate, even zero tax—and I am just using an extreme—and put those and required those to be put right back into employment and adding employees to these companies that would have to be structured so that it was an employee based—I mean, isn't that going to boost the growth here in the country? And I would ask any of you.

Mr. BERNSTEIN. Well, I mean, I think the idea of a repatriation, what you are talking about, some kind of repatriation of foreign earnings, has been found—and this is the Joint Tax Committee; this isn't a partisan thing—has been found to just incentivize more overseas deferral because they think they are going to get another repatriation somewhere down the road. If you have to do it, the way you described is a better way to do it, but it is a big revenue loser.

Mr. RENACCI. Well, it is a revenue loser if we are expecting to get it back. We are never getting it back.

Mr. Holtz-Eakin.

Mr. HOLTZ-EAKIN. The quick thing I would say is think long term. The tax reform should be designed to be a good Tax Code in any set of circumstances, whether we happen to be in a boom or a recession. You know, you don't want to tailor a permanent reform designed to enhance the supply side to the conditions of the moment.

Mr. RENACCI. Mr. Hassett.

Mr. HASSETT. And the last thought on this is just that the folks who have a lot of unrepatriated money are folks who by definition have a lot of money. And so the point is that the domestic firm—for sure I am for, you know, allowing people to repatriate money permanently, you know, for free, but to do it for 1 year, you are basically taking folks who have a lot of money and letting them bring it home. And it is not really plausible that Apple would employ more people in the U.S. right now if we didn't cut the corporate rate and just let them bring some money home because they have all the money they need at home already.

Mr. RENACCI. I would agree with you. It is not a 1-year program. I am just using that as an example because the only way to spur economic growth in this country is payroll. We have to increase payroll.

Thank you all for your time. I yield back.

Chairman BRADY. Thank you.

Mr. Rice, for the final question.

Mr. RICE. Thank you, Mr. Chairman.

I think everybody here agrees that more growth solves a lot of our problems, if not most of our problems, right? And I agree that post-recession growth has been muted, and it is disappointing. And I believe the reason for that is we are not competitive around the world.

Mr. Hassett, I am going to pick on you for a minute. If you have a company that—two companies, one is paying 35 percent tax, and the other is paying 15 percent tax, which one—and they are both selling to the same customers and they are both buying their products from the same suppliers, tell me the fate of those two companies.

Mr. HASSETT. Yeah. So what is going to happen is the 15-percent company is going to win, and the 35-percent company is going to go out of business; or the 15-percent company might buy the 35-percent company—

Mr. RICE. So—

Mr. HASSETT [continuing]. And after that purchase, they can move that—

Mr. RICE. So when an American company paying 35 percent tax moves to Ireland to pay 13 percent tax, it is not a matter of patriotism. Is it? It is a matter—

Mr. HASSETT. No.

Mr. RICE. It is a matter of pure economic survival.

Mr. HASSETT. That is the only way to survive.

Mr. RICE. Now, I want you to—whoever believes that we are competitive in our Tax Code, please raise your hand, in the world. Okay. We agree on that.

Whoever believes that our regulatory framework that costs \$10,000 per employee in the United States is competitive in the world, please raise your hand. We all agree on that.

Who agrees that our trade policy, our United States trade policy makes American companies, companies located here, more competitive in the world? Okay. We all agree on that. We are not competitive in any of those things.

Who agrees that our current unsustainable debt path makes us more competitive in the world? We agree with that.

Who agrees that our current policy on infrastructure and the failure to invest in infrastructure makes our companies more competitive in the world? We agree on that.

So we recognize that in all these major areas, this country is not acting competitively. This is not a Republican or Democrat issue. This is an America, the country, versus the rest of the world issue. And what we have to recognize, what the American people have to recognize and what the Republicans, Democrats, and the President have to recognize is that there are people around the world who get up every day and go to work in all these countries, and their job is to try to figure out how to beat America economically. And there is nothing wrong with that. And the only problem is that we refuse to compete. They are winning because we won't do it, and the American people know it. Two-thirds, two-thirds of Americans believe that their children will not have the same opportunities that they have had. If that is not a good economic indication, I don't know what is. Two-thirds.

We all agree. Everybody here agrees on this panel that we are not competitive, and we refuse to react. The President goes on TV. He complains about Congress. We sit here and fuss at each other. And nothing happens. All the while, more American jobs leave our shores. Our children can't find good-paying jobs. And the American people are sick of it. Hence, Donald Trump. I am sick of it too.



Let's show some leadership. We have got to get together and fix this. If we ever decide that we want to be competitive, we will make America great again.

Thank you very much. I yield back my time.

Chairman BRADY. Thank you. I would like to thank all of our witnesses for appearing before us today.

And please be advised, as you know, members may submit written questions to be answered later in writing, and the questions and your answers will be made part of the formal hearing record.

Again, the discussion is growth, the changes in competitiveness Mr. Rice referenced. We have a lot of work to do, and I am confident actually we can do this. In fact, we don't have a choice. We have to do it.

So, with that, the committee stands adjourned.

[Whereupon, at 12:52 p.m., the committee was adjourned.]

## Questions for the Record

**HEARING ON REACHING AMERICA'S POTENTIAL:  
DELIVERING GROWTH AND OPPORTUNITY FOR ALL  
AMERICANS**  
Questions for the Record

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**Question from Chairman Brady****Question:**

Dr. Hassett, in your written testimony you specify a number of studies published in the American Economic Review which demonstrate a strong relationship between taxes and economic growth. Would you please expand upon that list by citing other similar high-quality research? In addition to an expanded bibliography, we would welcome any comments or analysis you would like to include that may highlight the findings of that research.

*Beyond the articles in the American Economic Review mentioned in the testimony, other studies pointing to the same conclusion come from other economics journals. Turning to the German experience in the Oxford Economic Review, Hayo and Uhl (2014) use this "narrative approach" to examine German data spanning 1974 to 2010. They estimate that a tax increase of 1% of GDP cumulatively lowers output by as much as 2.4% over eight quarters. In aggregate, therefore, the estimated output effects from "narrative approach" analyses of the U.S., U.K., and German contexts evince a remarkable level of stability, ranging only from 2.4% over eight quarters in the case of Germany to 3% over ten quarters in the case of the U.S. context. Lopes (2016) replicates the approach and the results with data for Canada.*

*Other studies of the economic effects of tax reforms pivot away from the standard version of the "narrative approach" and instead emphasize the distinction between average and marginal tax rates, the latter of which tend to be the most relevant for policy discussions. Constructing a time-series of average marginal U.S. federal income tax rates from 1912 to 2006, Barro and Redlick (2010) repurpose a variation of the Romer and Romer (2010) identification strategy to construct an instrument for changes in average marginal tax rates (AMTRs). They find that a decrease in the AMTR of 1% increases per capita GDP by .5% after a period of one year. Deploying a vector autoregression, Mertens (2015) estimates a peak output effect from a 1% decrease in the AMTR on real GDP of 1.5%, though the sample includes only changes to personal tax rates and, in the interest of avoiding anticipation effects, excludes tax reforms with an implementation gap between time of legislation and time of implementation of one year or more. In conclusion, then, this diverse and variegated body of evidence from the economics profession points to a common and shared conclusion: lower taxes increase growth. Anyone who asserts that there is no evidence supporting a large impact of tax policy on the economy is either misinformed about the literature, or dishonest.*

*A full bibliography for both these studies and those in the American Economic Review is below.*

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### Questions from Rep. Boustany

#### Question 1:

##### Lead in:

Last year, I led a movement by this committee to reauthorize the Temporary Assistance for Needy Families (TANF) program. Throughout hearings and discussion drafts we focused on the need for welfare reforms to increase labor force participation, work and upward mobility.

The need to see this work move forward, seems nothing short of timely and extremely critical. Just last week Louisiana's Association of United Ways announced that more than 40 percent of individuals in Louisiana can't afford the basic necessities of life. That statistic further cements the fact that our nation's economy and anti-poverty programs aren't working as well as they should to help people move up the economic ladder.

##### Question:

Dr. Holtz Eakin, as you know, last year we held numerous hearings highlighting the fact that welfare recipients can sometimes find themselves in a situation where working more doesn't necessarily pay more. In your opinion, has the economic recovery been different for low wage workers?

*The recovery has been subpar, with especially slow job and wage growth among the low-wage workers. This is in part due to a previously legislated increase in the minimum wage early in the recovery, and as well due to the structure of the social safety net. There are certain elements of the social safety net that discourage work, in part due to short-term benefit tradeoffs. This is visible*

*among several programs such as Disability Insurance and TANF, where on a dollar for dollar basis, benefit receipts may equal entry-level wages, or at least offer equal value for a recipient's time. But this short-term calculus leaves out future benefits that accrue to work over time. Social safety-net programs that recognize these benefits by incenting work ultimately do a greater service to beneficiaries. Moreover, despite some rhetoric, even entry-level employees find less need for social safety net programs according to recent research completed by AAF.<sup>1</sup>*

**Follow up:**

Specifically, we released a discussion draft of a TANF reform bill that would revitalize the work requirement for people collecting welfare benefits. The discussion draft proposal ends the credits and loopholes, so states would be required to engage at least 50 percent of welfare recipients in work-related activities, as intended by the original 1996 law. Do you think this kind of reform can actually solve the problem or is it just one necessary piece of the puzzle to get people back to believing the American dream is possible? How would you contrast this approach be for constructive and self-sustaining as compared to the ongoing and aggressive calls by the President and democrats to raise the minimum wage?

*The entire social safety net needs to be reformed to better support work. A good start is to return to the original intent of the TANF work requirements.*

*In contrast, a minimum wage increase is exactly the wrong approach to addressing the need to enhance upward mobility. In effect, raising the minimum wage transfers wage earnings from the low-wage workers who are unfortunate enough to become jobless to the low-wage workers who remain employed.<sup>2</sup> Indeed, AAF has found that raising the minimum wage would cost 3.8 million low-wage jobs. In total, income among low-wage workers would rise by, at most, \$14.2 billion, of which only 5.8 percent would go to low-wage workers who are actually in poverty.<sup>3</sup> Instead the U.S. should pursue some specific pro-work policies targeted at this population, such as expansion of the childless EITC, paired with a robust growth agenda to grow the U.S. economy more rapidly.*

**Question 2:**

**Lead in:**

It is no secret that the oil and gas industry are critical to the state of Louisiana's economic stability. In fact, Louisiana loses about \$12 million every time the price of oil drops \$1. This has been felt more so in recent months as the price for a barrel of oil fell below \$27 a barrel for the first time since December 2003. In fact, in my hometown of Lafayette we have suffered the greatest number of job losses in the country over the past 12 months - losing 5,100 jobs in total. If those statistics don't highlight just how much the American economy is struggling right now, I'm not sure what does.

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<sup>1</sup> <http://americanactionforum.org/research/employment-the-retail-sector-and-usage-of-the-social-safety-net>

<sup>2</sup> <http://americanactionforum.org/research/higher-pay-fewer-jobs>

<sup>3</sup> <http://americanactionforum.org/research/counterproductive-the-employment-and-income-effects-of-raising-americas-min>

Dr. Holtz-Eakin, in December you highlighted that "*The best energy policy is letting markets work. A great testimony to this is the recent revolution in oil and gas production. It was due to market-driven technological advances that built on some government basic research and further industry development. It would be beneficial for consumers and producers alike if even more market forces were put in to play — namely to permit domestic producers to export crude oil (and accelerate the granting of permits to export liquified natural gas). Unfortunately, the U.S. approach to energy policy has often been to use tax and other policies to tilt the playing field. Wind power and solar power receive tax subsidies, while coal is penalized by the Environmental Protection Agency's regulatory agenda... The past 40 years of U.S. energy policy has consisted too much of federal intervention and micromanagement. The better route forward is to simply rely on the market forces that have delivered so much success in other parts of the economy, and recently in energy as well.*"

**Question:**

Knowing that you and I share concerns about the negative impact regulations placed on industry by the Administration are having to the overall economy, and that not all tax policy is helpful to the domestic business community, what do you think are the policy decisions we can and should be making right now, from the federal and local level, to implement an energy strategy for our country and to ensure Louisiana and the rest of the US is prepared to meet these challenges?

*A starting point would be to control the ever-increasing regulatory burden, which has grown by roughly \$100 billion annually for the past seven years. These regulations, as well as tax policy, distort the energy sector to the detriment of the American consumer and the economy as a whole. At present, the United States has a patchwork of subsidies and financing mechanisms layered onto federal and sub-national mandates and regulations, which rarely act in harmony to advance a coherent energy policy. Instead, the U.S. should get out of the energy "business," and allow market forces to take greater hold on the energy sector. Allowing U.S. producers to export crude oil is a positive step, but the administration's subsequent oil tax proposal reflects an approach to energy policy that appears rooted in the 1970s.*

**Question 3:**

**Lead in:**

With more than 95 percent of the world's population and 80 percent of the world's purchasing power outside the United States, future economic growth and jobs for Louisiana and America increasingly depend on expanding U.S. trade and investment opportunities in the global marketplace.

Export growth increases jobs by generating new business for Louisiana's manufacturers, service providers and farmers. It is well known that imports support jobs and keep costs low, helping Louisiana businesses compete and saving Louisiana families real dollars at the cash register. We know this well in Louisiana where more than one in five jobs depend upon international trade. In fact, according to labor statistics Louisiana's trade-related employment grew 2.5 times faster than total employment from 2004 to 2013.

**Question:**

Economists generally agree that trade liberalization, such as through the TPP, benefits Americans. How will the TPP benefit American families? In particular, will it lower costs on basic necessities such as clothes and shoes, which also happen to face high tariffs?

*A key goal of TPP is to eliminate or reduce tariffs on goods traded between partner countries, which should benefit families through more affordable consumer staples. TPP should also reduce foreign tariffs on American exports, which can encounter tariffs as high as 100 percent. Reducing both barriers should benefit American workers through enhanced opportunity for trade, and a reduction in costs for certain inputs and household goods. TPP also aims to increase trade in services, an essential element of U.S. trade, accounting for \$711 billion of exports in 2014.<sup>4</sup>*

**Follow up:**

In Louisiana the TPP is as much about what is under barges and ships in Gulf Coast rivers as it is about the goods they carry. This is because Louisiana's rivers are in dire need of dredging and the Army Corps of Engineers must continue to invest in maintaining locks and dams if the state is to reap the full benefit of the so-called Trans-Pacific Partnership. How critical do you all believe reliable infrastructure is for the U.S. to recognize the full benefits of TPP or any future trade agreement?

*Properly targeted, federal expenditures on infrastructure can enhance U.S. productivity and broadly benefit the American economy. To meet a productivity test, transportation investments should have a greater impact in terms of raising future standards of living than other uses of funds as measured by the return on other market investments. Thus, to ensure the best use of taxpayer dollars, government must channel funding to the projects that offer the highest returns to society. That means choosing programs that do the most to enhance long-term productivity.<sup>5</sup> Infrastructure projects that ensure access to international markets and trade routes can offer important opportunity for these productivity gains*

**Question 4:**

**Lead in:**

The long-term exponential growth in America's entitlement state has had far reaching consequences that we may not fully grasp for years to come, but there is no question for any of my colleagues on this committee, that the financial impact has trickled down to our respective states.

Perhaps most directly impactful on state's financial burdens is the Medicaid program; as everyone likely knows, Medicaid is jointly administered and financed at the federal and state levels, which is not the case for most other entitlement programs, and leaves states at higher financial risk. In fact, like many other states, my home state of Louisiana currently faces a budget gap of roughly \$1.9 billion, a figure that would only be further strained by any additional increases in spending.

**Question:**

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<sup>4</sup> <http://americanactionforum.org/insights/primer-the-trans-pacific-partnership>

<sup>5</sup> See: <https://media.mhfi.com/documents/201507-MHFIGI-Dynamic-Scoring-AAF-PPI-Final.pdf>

Dr. Holtz-Eakin, in your testimony submitted for the record, you highlighted the point that increased entitlement program spending has a depressive effect on our nation's economic growth overall, and ultimately leads to the need for increased revenue through tax increases elsewhere.

For states like Louisiana, who may be contemplating expansion of their Medicaid programs following on the recommendations made in the President's health care law, how would you advise Louisiana's new governor and others on the question of whether or not to follow through on expanding their Medicaid programs?

*Medicaid has impacts on health policy, budget policy, and economic policy. Beginning with the latter, Medicaid is poor economic policy. A recent estimate by AAF found that a nationwide Medicaid expansion would result in a direct net loss of up to \$174 billion in economic growth nationwide over ten years and the loss of over 206,000 full-year-equivalent jobs for the years 2014 to 2017.*

*Medicaid is questionable budget policy. The ACA's Medicaid expansion layered \$824 billion in entitlement spending onto an already unsustainable federal budget, that left unchecked will harm future economic growth.<sup>6</sup> States have to be cognizant that the Medicaid expansion is not "free" and that the terms may worsen in the near future.*

*Finally, states are much better situated to determine their low-income health policies than is the federal government.*

**Follow up:**

If you would advise against expansion, can you elaborate as to why Medicaid program expansion is not ultimately cost-efficient or successful at achieving the President's purported goals of expanding coverage to ensure timely access to high-quality healthcare services?

*Perhaps more important than its budgetary implications, is the failure of Medicaid to deliver quality care to the neediest Americans. There is evidence that Medicaid coverage does not increase overall health or reduce emergency room use.<sup>7</sup> Indeed, Medicaid coverage arguably leads to the worst health outcomes because reimbursement rates for providers are so low that it makes non-emergency room care virtually inaccessible.<sup>8</sup> As noted above, states may have much better solutions on their own.*

Lastly, can you describe for me what you think the long-term financial impact would be on a state like Louisiana, with its \$1.9 Billion budget gap, if the decision was made to expand Medicaid?

*Over the long-term, it is basic math that increasing the Medicaid-eligible population will increase future liabilities. While the ACA promises to cover the bulk of this expansion, future Congress are*

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<sup>6</sup> [https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50252-Effects\\_of\\_ACA\\_Repeal.pdf](https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50252-Effects_of_ACA_Repeal.pdf)

<sup>7</sup> <http://americanactionforum.org/insights/more-insurance-shouldnt-lead-to-more-emergency-room-visits-but-it-might>

<sup>8</sup> <http://americanactionforum.org/testimony/the-affordable-care-act-after-five-years-wasted-money-and-broken-promi>

*not bound to any current financing structure. We have even seen States experience cost increases in the short term, being held hostage by maintenance-of-effort provisions that force state Medicaid agencies to continue paying for temporary programs that have long since expired.*<sup>9</sup>

**Question 5:**

**Lead in:**

As many of my colleagues on this committee can attest, the constituents in each of our respective states have been “white-knuckling” the wheel of a stagnant economy, trying to hang on until things “get better”. In fact, my home state of Louisiana closed 2015 ranking 48<sup>th</sup> in the U.S. for positive economic growth, alongside a 6.3% unemployment rate well above the national average of 5.0%, and 0.0% wage growth

Louisiana, alongside every one of the 50 U.S. states, serves as a major hub for international business across many industries. There has been an exponential growth in inversions, and mergers and acquisitions activities, most recently the sale of Johnson Controls to Ireland-based Tyco, as well as the sale of U.S.-based Baxalta to Ireland-based Shire. Following the loss of these two major U.S. companies alongside the many others that preceded them, this is only further evidence to support the critical need for tax reform.

Dr. Holtz-Eakin, in your submitted testimony you made the accurate and astute observation that economic growth is positively correlated with a very tangible result for American families: *“The Congressional Budget Office projects the U.S. economic growth to average only 2.1 percent over the next decade...This rate of growth is below that needed to improve the standard of living at the pace typically enjoyed in post-war America...**More rapid growth is not an abstract goal; faster growth is essential to the well-being of American families.**”*

**Question:**

Dr. Holtz-Eakin, given the concrete connection between our nation’s economic growth, and therefore the well-being of American families, do you believe international tax reform to address the increasing inversions and mergers-and-acquisitions activities will have a positive economic effect that trickles down to small business and American families?

*Well-designed tax reform does offer the promise of stronger economic growth and better international competitiveness, and as noted in the testimony, can boost wages and employment. Tax reform proposals offering these gains should be favorably by the Committee. In the current environment, the Committee would also do well to avoid considering tax policies that may harm an already weak economic recovery. Some proposals in Congress would hasten the departure of some U.S. firms, eroding the U.S. tax base and taking high-wage jobs along the way.*

**Follow-up:**

Can you explain how America’s loss or retention of these large U.S.-based companies going forward stands to impact availability of jobs across the 50 United States and D.C.?

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<sup>9</sup> <http://americanactionforum.org/testimony/the-affordable-care-act-after-five-years-wasted-money-and-broken-promi>



*The combination of growing markets abroad and the maintenance of a highly uncompetitive tax code has resulted in, and is projected to continue to induce equity flight abroad. Estimates suggest that roughly 15 percent in U.S. based capital is at risk of moving overseas. Anti-inversion laws that include management and control tests such as some before this Congress would push the capital overseas and headquarters jobs would follow suit. According to a recent estimate by AAF, the largest American firms have nearly 299,000 headquarters employees, many of which would be at risk for having their positions relocated abroad. If roughly 15 percent of U.S. based market capital is at risk, it suggests a proportional overseas relocation of 42,000 U.S. jobs.<sup>10</sup>*

Furthermore, how does the loss of major U.S. headquartered companies to our foreign counterparts ultimately impact everyday American families like those in my home state of Louisiana?

*According to research from the Harvard business school, “corporate headquarters in the United States are about twice the size of European counterparts yet appear to be more effective.”<sup>11</sup> Losing these corporate entities means losing thousands of jobs, often high-paying managerial jobs that offer a sizeable tax base to a community and relatively higher standards of living. Moreover, major corporate headquarters play an outsized role in their local communities – one need not look beyond donors to local civic, educational, and health institutions to appreciate the impact that losing a corporate resident can have on a local community.*

#### **Question 6:**

##### **Lead in:**

As many of my colleagues on this committee can attest, the constituents in each of our respective states have been “white-knuckling” the wheel of a stagnant economy, trying to hang on until things “get better”. In fact, my home state of Louisiana closed 2015 ranking 48<sup>th</sup> in the U.S. for positive economic growth, alongside a 6.3% unemployment rate well above the national average of 5.0%, and 0.0% wage growth

Louisiana, alongside every one of the 50 U.S. states, serves as a major hub for international business across many industries. There has been an exponential growth in inversions, and mergers and acquisitions activities, most recently the sale of Johnson Controls to Ireland-based Tyco, as well as the sale of U.S.-based Baxalta to Ireland-based Shire. Following the loss of these two major U.S. companies alongside the many others that preceded them, this is only further evidence to support the critical need for tax reform.

##### **Question:**

Dr. Hassett, given the concrete connection between our nation’s economic growth, and therefore the well-being of American families, do you believe international tax reform to address the

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<sup>10</sup> <http://americanactionforum.org/research/the-economic-risks-of-proposed-anti-inversion-policy>

<sup>11</sup> <http://hbswk.hbs.edu/item/international-differences-in-the-size-and-roles-of-corporate-headquarters-an-empirical-examination>

increasing inversions and mergers-and-acquisitions activities will have a positive economic effect that trickles down to small business and American families?

**Answer:** *When it comes to corporate taxation, the evidence for the existence of this “free lunch” from international tax reform that would benefit American workers and small businesses is strong.*

*The United States has the highest official or “statutory” corporate tax rate of any country in the OECD. But many who dispute the need for broad pro-growth tax reform would point out that the “effective” tax rate paid by corporations is lower than this official legislated rate, due to tax credits etc. Still, even if one accounts for the many loopholes in the tax code that corporations exploit and examines the “effective” rate that U.S. corporations pay rather than the statutory rate legislated by Congress, U.S. corporate tax rates remain elevated relative to those in other OECD countries. International tax reform to address inversions would entail lowering the U.S. corporate tax relative to the tax rate in other countries, in order to make the U.S. a relatively more attractive tax jurisdiction. To be sure, other countries might well follow suit, and the disadvantage of having relatively high rates might reemerge. But the competition between countries for capital is a force that drives rates toward their optimal level. We should play the game by reducing rates, and we should celebrate its existence. Right now we are on the sidelines, and our firms and workers are suffering because of it.*

*However, if there were successful international tax reforms that rendered the U.S. a relatively “less expensive” place to do business relative to its OECD peers, American workers and American small businesses would benefit. Such reform would mute the incentive that now motivates firms to undertake inversions and mergers-and-acquisitions activity that effectively results in an inversion. This would save the jobs that firms take with them abroad when they engage in these activities and shift their tax jurisdiction to, say, Ireland. Small businesses, too, would benefit. One channel would be through the reinvigoration of local economies that would result from the presence of the additional jobs in a local economy; the local tailor would do better when there are more men wearing suits to corporate jobs than when those jobs are offshored to Ireland for tax purposes. A second channel would be through effects that may be mediated by business-to-business economic activity that occurs along the supply chain; as corporate offices remain in the U.S. rather than invert to Ireland, they would be buying, say, office supplies and food from local producers in the U.S. rather than local producers in Ireland. And the employees of the big multinational would learn valuable business skills, and then start new firms on their own.*

**Follow-up:**

Can you explain how America’s loss or retention of these large U.S.-based companies going forward stands to impact availability of jobs across the 50 United States and D.C.?

Furthermore, how does the loss of major U.S. headquartered companies to our foreign counterparts ultimately impact everyday American families like those in my home state of Louisiana?

**Answer:**

*Going forward, the loss or retention of large U.S.-based companies stands to have a significant impact on the availability of jobs in the 50 states and D.C. In today's globalized economy, America must compete as a tax jurisdiction to attract mobile businesses and the jobs they bring with them. And, as many members of this Committee are likely aware, businesses and corporations cast a "vote with their feet" as they choose to locate in a given jurisdiction. Today, businesses are voting against the status quo of American tax policy when they "invert" and move to a new jurisdiction, taking jobs with them. Unfortunately, then, it is the American worker—the American voter—that suffers when corporations vote against America's corporate tax policy. Whether this trend continues or abates depends on whether the U.S. undertakes the tax reforms that are necessary to ameliorate the powerful economic incentives that are today driving corporations and the jobs they create away from the 50 states and D.C. There is no natural limit to this process. It might well be that, in the fullness of time, every U.S. multinational will invert. The economic incentives to do so are that powerful.*

*The loss of major U.S. headquartered companies ultimately has a devastating impact on everyday American families like those in Louisiana. The absence of these jobs at corporations prevents families from enjoying the income and economic stability that families in America have traditionally had the opportunity to enjoy. There is a voluminous literature that relates unemployment to maladies as wide-ranging and profound as the future earnings of children and the incidence of suicide. The retention of corporations and the jobs they provide is a matter of dire importance and grave stakes for families in every state in the U.S., including Louisiana.*



**Public Submissions for the Record**



**Statement for the Record  
House Committee on Ways and Means  
Hearing on "Reaching America's Potential: Delivering Growth and Opportunity for All Americans"  
February 2, 2016**

Stephanie Silverman  
President & Executive Director  
Employee-owned S Corporations of America  
1341 G Street, NW, 6<sup>th</sup> Floor  
Washington, DC 20005

On behalf of the Employee-Owned S Corporations of America (ESCA), thank you for the opportunity to submit comments to the House Committee on Ways and Means. We commend the Committee for its continued focus on policies to drive economic growth, which are essential in addressing the difficulties that continue to vex the U.S. economy, working Americans, and their families.

ESCA represents private employee-owned companies operating in every state across the nation, in industries ranging from heavy manufacturing to construction to school photography to grocery stores. The expansion of S corporation ESOPs (employee stock ownership plans) in recent years is testimony to the fact that these companies are a dynamic and growing part of our economy. Currently, about 3,000 companies are S corporation ESOPs, and they employ 470,000 workers across the country and support nearly a million jobs in all. We would respectfully suggest to the Committee that a vital means of promoting economic opportunity for working Americans is to expand the availability of S corporation ESOPs for more companies and their workers.

On January 26<sup>th</sup>, economist Jared Bernstein, former chief economist for Vice President Biden, who testified at this hearing, released new research that reflects the benefits of expanding private employee ownership of U.S. businesses. In remarks during the hearing, Congressman Kind requested that Bernstein's report be entered into the hearing record. By increasing ownership of business capital, the study shows, ESOPs reduce wealth and wage inequality among workers. The fact that they only do this on a small scale, Bernstein asserts, is due to the fact that there are limited numbers of ESOPs in the United States. More ESOP companies would, he made clear, have an even greater and more beneficial impact on closing the growing wage and inequality gap in the American workforce.

Other key findings from Bernstein's new study include:

- That ESOPs help to address growing wage gaps between top management and other workers because they generally pay their workers better (and that the ESOP benefits companies offer aren't generally a substitute for other compensation);
- That ESOP-owned companies provide more stable employment than other businesses, and private, employee-owned companies are better able to weather economic downturns (like the Great Recession);
- That there isn't much behind assertions that employees who are part of ESOPs are in danger of being 'over exposed' to company stock. Bernstein notes that the great majority of ESOP-owned companies provide employees with an additional 401(k) or other similar plan, making their ownership stake in the company additive and highly beneficial.

Bernstein's report expands on what we already know: S corporation ESOPs are doing exactly what Congress intended when it created them in the late 1990s - generating economic activity, creating jobs, and promoting retirement savings. By any measure, these companies have been a remarkable success story, and a bright spot in an economy characterized over the course of the last decade or more by sluggish growth, anemic job creation, worker insecurity and wealth inequality.

It stands to reason that companies with ESOPs have displayed a dynamism and vitality lacking in other sectors of our economy. An ownership stake in one's place of work is not only a reason to help drive to greater productivity, but it also inspires greater loyalty as workers consider themselves aligned with the fortunes of the business, and avoid adversarial dynamics that can emerge when employees are convinced that the interests of stockholders and corporate board members are at odds with their own. For workers in S corporation ESOP firms, what is good for ownership is good for them by definition.

The evidence is compelling that expanding the availability of S corporation ESOPs for more companies and their workers would not only boost the retirement savings of countless Americans, but would also create more jobs, generate more economic activity, and encourage the formation of businesses that are more stable and successful because they provide their employees with the kind of built-in incentives conducive to loyalty and productivity.

As the Ways and Means Committee contemplates pro-growth measures, ***we urge members to support tax policies that expand the availability of S corporation ESOPs, allowing more workers to own their businesses and benefit from the advantages that employee-ownership holds.***

Toward that end, H.R. 2096 --introduced by Committee members Dave Reichert and Ron Kind along with Reps. Pat Tiberi, Richard Neal, Erik Paulsen, Earl Blumenauer, Charles Boustany and Bill Pascrell -- would help to grow the number of private ESOP businesses in the United States, giving more workers the opportunity to build savings, reduce wealth and wage inequality, and retire with dignity. The measure includes provisions to extend the gain-deferral provisions of Code section 1042 to sales of employer stock to SESOPs, encourage the flow of bank capital to ESOP-owned S corporations, provide resources to small businesses contemplating making the transition to an ESOP, and ensure that SBA-certified small businesses do not lose their status by becoming employee owned. H.R. 2096 currently has 63 bipartisan cosponsors (including 21 members of the Ways and Means Committee)

We look forward to working with Committee members to advance H.R. 2096 toward this year. We thank the Committee for its continued championship of employee ownership through the S ESOP model, and more broadly for its work on pro-growth policies for working Americans.

#### **Additional Background on S Corporation ESOPs**

A Subchapter S corporation is a business entity that provides flow-through tax treatment to its shareholders. An employee stock ownership plan (“ESOP”) is a qualified defined contribution plan that provides a company’s workers with retirement savings through their investments in their employer’s stock, ***at no cost to the worker***. ESOPs are regulated by the Employee Retirement Income Security Act (“ERISA”) just like pension funds, 401(k) plans, and other qualified retirement plans.

In 1996, in the Small Business Jobs Protection Act, Congress authorized the S corporation ESOP structure, effective January 1, 1998, with the goal of encouraging and expanding retirement savings by giving American workers a greater opportunity to have equity in the companies where they work.

In the Taxpayer Relief Act of 1997, Congress repealed the unrelated business income tax (UBIT) originally imposed on the ESOP for its share of S corporation income, enabling S corporation ESOPs to become a viable new business structure to benefit American workers. Seventeen years later, there are more than 2,600 S ESOP companies operating in every state of the nation, in industries ranging from heavy manufacturing to retail grocery stores, from construction to consulting. Because of the structure of S ESOP tax policy, S ESOPs are achieving exactly what Congress intended: generating unparalleled retirement savings for workers, providing good and resilient jobs in high-performing businesses, and creating important macroeconomic benefits in their communities.

Over the years, ESCA has worked closely with federal policymakers to ensure that S ESOPs hold true to their original purpose of encouraging broad employee ownership. We collaborated with members of your committee in 2000-2001 to craft anti-abuse rules that became section 409(p) of the Internal Revenue Code. These rules, enacted in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), now mandate that S ESOPs provide for broad-based employee ownership and establish strict repercussions for violations.

*As the report language for EGGTRA (H.R. Rep. No. 107-51, part 1, at 100 (2001) states: The Committee continues to believe that S corporations should be able to encourage employee ownership through an ESOP. The Committee does not believe, however, that ESOPs should be used by S corporation owners to obtain inappropriate tax deferral or avoidance.*

*Specifically, the Committee believes that the tax deferral opportunities provided by an S corporation ESOP should be limited to those situations in which there is broad-based employee coverage under the ESOP and the ESOP benefits rank-and-file employees as well as highly compensated employees and historical owners.*

Since enactment, Section 409(p) has been highly effective in ensuring that S ESOPs serve their purpose. As a result, S ESOPs have become perhaps the most effective retirement savings plan under federal law, and today the average S ESOP plan participant has significantly more money saved in their ESOP account than they do in their 401(k) account.

#### **The Unparalleled Performance of S ESOPs**

Many studies over the years have documented why and how S ESOPs have proven to be so powerful for both workers as a retirement savings and economic security tool, and how they have contributed substantially to communities and the broader national economy.

Last year, Ernst and Young’s Quantitative Economics and Statistics (QUEST) practice issued a study showing that **S corporation ESOPs outperformed the S&P Total Returns Index in terms of total return**

**per participant by an impressively large margin (62%),** net assets of S ESOP accounts in the aggregate increased over three-fold, and retirement distributions to workers in S ESOPs totaled nearly \$30 billion from 2002 to 2012.

In a study released in 2014, data compiled by the National Center for Employee Ownership (NCEO) shows that private employee-owned businesses have strikingly fewer loan defaults than other businesses. **NCEO finds that the default rate on bank loans to ESOP companies during the period 2009-2013 was, on average, an unusually low 0.2 percent annually.** By contrast, mid-market companies in the U.S. typically default on comparable loans at an annual rate of 2 to 3.75 percent. The tenfold difference between the economic strength of employee-owned companies and other businesses highlights the fact that **private businesses which are owned by their employees have the incentives and vision that makes them more stable, more successful, and better for employees as well as the larger economy.**

A 2012 study by Alex Brill, a former chief economist and policy director to the Ways and Means Committee and tax advisor to the Simpson-Bowles deficit reduction commission, found that:

- Employment among surveyed S ESOP firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period.
- In the struggling manufacturing industry in particular, the S ESOP structure has buffered against economic adversity and job loss.
- S ESOPs have significantly expanded the pool of US workers who are saving for retirement, while also boosting company productivity – something that has greatly benefited their employee-owners.

In his study, Brill notes that “in the context of the current tax reform debate that seeks to curtail existing tax expenditures in favor of lower statutory rates, policymakers should recognize the evidence in support of S ESOPs and their positive economic contribution.”

In 2013, Brill produced a follow-on study entitled “Macroeconomic Impact of S ESOPs on the U.S. Economy.” Key findings of that broader assessment revealed that:

- **the number of S ESOPs and the level of active participation (number of employee-owners) have more than doubled since 2002.**
- **total output from S ESOPs and the industries they support is nearly 2 percent of GDP.**
- **S ESOPs directly employ 470,000 workers and support nearly a million jobs in all.**
- **S ESOPs paid \$29 billion in labor income to their employees, with \$48 billion in additional income for supported jobs.**

Brill’s study on the macroeconomic impact of S ESOPs built upon findings issued in 2008, in a 2008 University of Pennsylvania report, whose authors found that S ESOPs contribute **\$14 billion in new savings for their workers each year beyond the income those workers otherwise would have earned,** and that S corporation ESOPs offer workers greater job stability and increased job satisfaction. The study also found that S corporation ESOPs’ higher productivity, profitability, job stability and job growth generate a collective **\$19 billion in economic value that otherwise would not exist.**

The Brill and University of Pennsylvania studies reinforce other important evidence about S ESOPs that show how powerful they can be.

In a 2010 Georgetown University/McDonough School of Business study, two leading tax economists, former Treasury Department officials Phillip Swagel and Robert Carroll, reviewed the performance of a cross-section of S corporation ESOP companies during the early part of the prior recession and found that these companies performed better than other equivalent companies in terms of job creation, revenue growth, and worker retirement security. Specifically, Swagel and Carroll found that:

- **Companies that are S corporation ESOPs are proven job-creators, even during tough times.** While overall U.S. private employment in 2008 fell by 2.8%, employment in surveyed S corporation ESOP companies rose by 2%. Meanwhile, 2008 wages per worker in surveyed S corporation ESOP companies rose by 6%, while overall U.S. earnings per worker grew only half that much.
- **S corporation ESOP companies provided substantial and diversified retirement savings for their employee-owners at a time when most comparable companies did not.** Despite the difficult economic climate, surveyed S corporation ESOP companies increased contributions to retirement benefits for employees by 19%, while other U.S. companies increased their contributions to employee retirement accounts by less than 3%.

As the Ways and Means Committee continues to work on comprehensive tax reform, ESCA would be pleased to serve as a resource and we look forward to continuing this important dialogue about a corporate structure and retirement savings plan that is enabling hundreds of thousands of Americans to achieve the American dream at work.

*The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.*



Statement for the Record for

**Full Committee Hearing**

**“Reaching America’s Potential: Delivering Growth and Opportunity for All Americans”**

**February 2, 2016**

The following statement is submitted by The ESOP Association, located at 1200 18<sup>th</sup> Street, NW, #1125, Washington, D.C. 20036, phone 202-293-2971. The person who drafted the following statement is J. Michael Keeling, President, email [michael@esopassociation.org](mailto:michael@esopassociation.org)

“Before setting forth the evidence why employee stock ownership plans, referred to as ESOPs, should be promoted and encouraged as a means of expanding our nation’s growth for providing more opportunity for all citizens to share in our free enterprise system, it is appropriate to set forth what an ESOP is, and its history, for the past 41 years of laws promoting the creation and operation of employee stock ownership via the ESOP model.

**What Is an ESOP?**

Unique among ERISA plans, an ESOP, by law, must be primarily invested in the highest class of stock of the plan sponsor and the stock may be acquired with borrowed funds. In practical terms, the plan sponsor may take on ‘debt’ to acquire shares of the sponsor, and not be engaged in a prohibited transaction if the shares are acquired by the ESOP trust at a price no greater than the fair market value.

**Brief History of ESOPs**

The ESOP model of employee ownership actually has its roots in a compensation practice from the 19<sup>th</sup> Century. (A recent book, The Citizen’s Share, Blasi, Freeman, and Kruse, Yale Press, wrote a very convincing case, pages 1 – 56, that our founding fathers, such as Washington, Jefferson, Adams, Hamilton, et al, believed in broad ownership of productive assets as being essential to the survival of a democracy. President Lincoln’s views, as evidenced by the Homestead Act, were also in sync with our founding fathers’ views.)

As the U.S. economy moved into the industrial age, corporations with nationwide reach, and large numbers of employees emerged — Procter & Gamble, Montgomery Ward, and others. Leaders of these companies realized that some employees would work for many years, reach an age requiring retirement, and retire with no income. There was no 19<sup>th</sup> Century safety net for retirees, and leaders of a number of national firms decided to set aside company stock for the employees to have when they retired, and to “cash in.”

After World War I, and the ratification of the 16<sup>th</sup> Amendment to the Constitution authorizing a national income tax, Congress recognized that taxing income was not so simple, and that many issues had arisen because the basic definition that income is anything of value received by an individual, and the general rule that an income tax should tax anything of value.

In response to questions of what income should be taxed, Congress developed the very first true income tax code, the Code of 1921.

In developing the Code, those firms that were setting aside stock for their retiring employees came to the House Committee on Ways and Means and asked — “Is the stock set aside for an employee’s retirement taxable when set aside, and is the value of the stock an employer’s compensation cost?”

The Ways and Means Committee decided no, it was not current income to the employee, but would be taxed when the employee realized the previously deferred income; and yes, the set aside was compensation, and thus a cost of business for the employer and thus deductible for income tax purposes.

Thus, the first deferred compensation plan recognized by Congress was the “stock bonus plan,” the forerunner of today’s ESOP.

Fast forward to post War World II and owners of privately-held businesses began to consider how to “exit” their businesses and “cash” in their non-tradable stock in the company they started and which had become successful because of the hard work of the company employees. While somewhat lost in history due to the fact that until the mid-1970s private letter rulings were not public documents, an owner in Alaska, followed by others, obtained permission from the IRS, in a non-public letter ruling, that the company could “buy” his stock with borrowed money, have the stock placed in the company’s stock bonus plan, and have the stock allocated to the employees as the debt was paid off.

A true visionary in San Francisco, California, Dr. Louis O. Kelso, developed a comprehensive economic philosophy in using such a method for funding stock bonus plans to expand ownership in a capitalistic society and to facilitate capitalization of for-profit businesses. He and his law firm colleagues led the way in expanding the use of this method blessed by the letter rulings, and many correctly note that the first “ESOP” was the sale by exiting shareholders of the *Monterrey Press* north of San Francisco in 1957 to an ESOP.

By the mid-1950s, many, both conservative and liberals, were seeing abuses in the area of pensions, or tax qualified deferred compensation plans, which the tax laws sanctioned and encouraged. Evidence was overwhelming that some pension funds were investing in organized crime activities. Then there was the collapse of major U.S. employers, leaving employees with no retirement income as promised. As a result, a drive in Congress to “reform” the tax and labor laws governing tax qualified deferred compensation plans, or “retirement savings plans,” led to the enactment of ERISA in 1974.

During Congressional work on these “tax qualified deferred compensation plans,” a major influence on tax policy of that era, Senator Russell B. Long, long time chair of the Senate Committee on Finance, became a champion of the economic philosophy of Dr. Kelso, and made sure the new ERISA law sanctioned ESOPs.

His support for the ESOP model grew stronger with each passing year, and his leadership led to major enactment of tax laws promoting the creation and operation of ESOPs. The bulk of these laws passed in 1984, in legislation referred to as DEFRA, and the perfection of those laws were in the Tax Reform Act of 1986.

In 1984 and 1986, Ways and Means members on the Conference Committee with members of the Senate Finance Committee, accepted nearly all provisions in the Senate bill promoting ESOPs.

In 1997, it was the Ways and Means Committee, by unanimous vote, accepted an amendment to the 1997 tax bill permitting S corporations to sponsor ESOPs. Former Congresswoman Nancy Johnson authorized the amendment.

Many of these laws of the 1980s, and the “Johnson” amendment remain in the Code.

While casual observers mistakenly think only the Senate Finance Committee reviewed the impact of ESOPs on employees, their companies, and our economy, the Ways and Means Committee had four oversight hearings on ESOPs in the period of 1987-1990. And in 2014-2015, the Committee's work on laying a foundation for comprehensive tax reform, led to former Chair Camp's tax reform proposal maintaining all current tax laws that encourage the creation and operation of ESOPs.

To be noted, a major partner with Senator Long promoting ESOPs in the 80s through 1988, was former President Ronald Reagan, who often spoke of his view that widespread ownership of productive assets was the core of maintaining equitable wealth ratios in a capitalistic society.

In sum, the Ways and Means Committee has a long, and a recent history, of supporting more employee stock ownership via the ESOP model.

#### **ESOPs, Ways and Means, and the 114<sup>th</sup> Congress**

It is important to note support for employee stock ownership by members of Ways and Means.

While the national media and, men and women running to be their parties' nominees for President in 2016, love, and the word love is used on purpose, to refer to members of Congress – which of course includes all members of Ways and Means, as “stupid”, corrupt, lackeys of special interest groups, who do not “get along” for the good, the fact is ESOPs enjoys support from both Democrats and Republicans, liberal, moderate, and conservative members of Ways and Means.

For example, on April 29, 2015, eight members of Ways and Means, four Republicans and four Democrats, introduced H.R. 2096 – Representatives Reichert, Kind, Tiberi, Neal, Paulsen, Blumenauer, Boustany, and Pascrell. (Summary of H.R. 2096, Attachment 1) Since then, eleven more members of H.R. 2096 have joined their colleagues. Five other Ways and Means Committee members co-sponsored the same bill (H.R. 4837) in the 113<sup>th</sup> Congress.

The question is **WHY?** Why has a bi-partisan group of women and men serving in the House renewed evidence of a mainstream view set forth by the Congress since 1975 that the expansion of employee stock ownership via the ESOP model would be good public policy?

Just to include in this statement for the record some of the evidence why employees, their companies, and our economy all benefit from being owners through an ESOP, below are quick summaries of respected findings over the past two decades.

1. Since the 2002 prestigious General Social Survey up to the recently released 2014 GSS, evidences clearly that companies with employee stock ownership are much more likely to have layoff rates that are significantly less than conventionally owned companies—3% in 2002 for companies with employee ownership, 9.2% conventionally owned; 2006, 2.3% versus 8.5%; 2010, 2.6% versus 12.3%; and 2014, 1.3% versus 9.5%. Most impressive are the 2010 numbers, reflecting layoffs during the Great Recession. (Note that further data crunching by the National Center for Employee Ownership indicated that the fact these companies with employee stock ownership had fewer layoffs generated \$14 billion dollars due to employees paying income, Social Security, and Medicare taxes, and not taking Unemployment Compensation or Food Stamps, seven times more than the general revenue estimates for the “tax expenditures” of special ESOP tax rules.)
2. A study of 1100 ESOP companies in the late 90’s, compared to counterparts in the same industry, by Rutgers Professors Dr. Blasi, and Kruse, evidenced the ESOP companies had better sales, more employment, and were by a rate of 16% greater than their competitors over an 11-year period to remain independent.
3. Highly valued as a one source of history and data about employee stock ownership, and the ESOP model in particular, is the book “*The Citizen’s Share*”, by Dr.’s Blasi, Kruse of Rutgers, and Dr. Freeman of Harvard. The easy to read volume contains reference to nearly all of the research over the past 30 years with regard to the performance of ESOPs, both as a wealth creation, retirement savings, and as a jobs policy.

Attachment 2 is a fuller summary of research and its data of the track record of ESOP companies, and their reward of average pay employees.

In sum, Chair Brady and members of the Committee on Ways and Means, there is ample data, and real world experience to continue the push by the Committee to increase employee stock ownership. Bottom line, ESOPs are more productive, more sustainable, with jobs controlled by U.S. interests.”

**Attachment 1**

**Summary of H.R. 2096  
“Promotion and Expansion of Private  
Employee Ownership Act of 2015”  
(Same as Last Congress H.R. 4837)**

H.R. 2096 will:

1. Permit owners of S stock to sell the stock to an ESOP and defer the capital gains tax on his/her gain if the proceeds are reinvested in the equities of U.S. operating corporations as owners of C corporations stock have done under IRC 1042 since 1984;
2. Permit lenders to S corporations with 50% or more ownership through an ESOP to exclude 50% of the interest from the loan, if used to acquire stock for the ESOP;
3. Establish an office in the Department of Treasury to provide technical assistance to S corporations with ESOPs;
4. Provide that a small business, S or C, eligible for one of the many programs provided by the Small Business Administration to remain eligible for SBA programs if the company becomes owned 50% or more by an ESOP, and the workforce remains the same or nearly the same as before the establishment of the 50% ownership by employees through the ESOP.

**General Explanation**

1. As evidenced in [name of your company] employee stock ownership plans are benefiting [name of company], our employees, and [name of your city or town.]
2. There is ample macro-data evidencing that the benefits our ESOP provides to [name of company] is also the case in the vast majority of privately-held ESOP companies in America.
3. H.R.2096 is a modest proposal that will not cost any significant tax revenues, and will build even larger account balances for retired employee owners, who will pay more taxes on their ESOP distributions than the targeted tax expenditure for ESOPs in H.R. 2096. For example, more ESOPs will be created, certain existing ESOP small businesses will qualify for SBA loans, and all S ESOP private companies can access Treasury experts on the complex rules governing S ESOPs.
4. In short H.R. 2096 will address the growing concerns of individual access to ownership, equitable distribution of our nation's capitalism, in companies that are more productive, more profitable, and more sustainable providing locally controlled jobs.

## Attachment 2



**Employee Owner Impact Corporate Performance Positively  
Overwhelming Evidence ESOP Companies More Productive, More  
Profitable, and More Sustainable, Providing Locally Controlled Jobs**

- During the Great Recession, employee stock owned companies laid off employees at a rate of less than 3%, whereas conventionally owned companies laid off at a rate greater than 12%. (Data source: 2010 General Social Survey.)
- Because employees of ESOP companies were four times more likely to retain jobs during the Great Recession, Federal government recognized savings of over \$14 billion in 2010 compared to tax payments foregone by laid off employees of conventionally owned companies; in other words for every \$1 in tax expenditures to promote employee stock ownership, the Federal government collected \$13 in taxes. (Data Source: 2010 General Social Survey analyzed by National Center for Employee Ownership.)
- A survey of 1,400 ESOP companies in 2010 evidenced the average age of the companies' ESOPs were 15 years, and the average account balances for employees were nearly \$200,000, much higher than data reported for average 401(k) account balances. (The ESOP Company Survey, 2010, of The ESOP Association's Corporate members.)
- According to 2012 General Social Survey, 13% of employees of employee stock-owned companies were thinking of seeking employment elsewhere, whereas 24% of the employees of conventionally-owned companies were considering leaving their current job.
- In the summer of 2014, the Employee Ownership Foundation released results from the 23<sup>rd</sup> Annual Economic Performance Survey (EPS) of ESOP companies. Since the Employee Ownership Foundation's annual economic survey began 23 years ago, a very high percentage, 93% of survey respondents, have consistently agreed that creating employee ownership through an ESOP was "a good business decision that has helped the company." It should be noted that this figure has been over 85% for the last 14 years the survey has been conducted. In addition, 76% of respondents indicated the ESOP positively affected the overall productivity of the employee owners. In terms of revenue and profitability --- 70% of respondents noted that revenue increased and 64% of respondents reported that profitability increased. In terms of stock value, the majority of respondents, 80%, stated the company's stock value increased as determined by outside independent valuations; 18% of the respondents reported a decline in share value; 2% reported no change. The survey also asked respondents what year the ESOP was established. Among those responding to this survey, the average age of the ESOP was 16 years with the average year for establishment being 1998.
- More than half of the ESOP companies have two retirement savings plan (primarily a 401(k)), whereas more than half of all companies have no retirement income savings plan. (Analysis of forms 5500, and Bureau of Labor Statistics by the National Center for Employee Ownership, funded by the Employee Ownership Foundation.)
- The average ESOP company (less than 200 employees) has sales \$9 million more per year than its non-employee owned comparable competition. (June 2008 Dissertation, Dr. Brent Kramer, CUNY.)
- A study of 1100 ESOP companies over eleven years compared to 1100 comparable conventional owned companies evidenced the 1100 ESOP companies had better sales, more employment, and were more likely over the period to remain independent businesses by 16%. (Most detailed study of ESOP companies by Dr. Joseph Blasi, and Dr. Douglas Kruse, tenured professors, Rutgers University School of Labor and Management, 1999.)

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**Reforming America's Taxes Equitably (RATE) Coalition**  
Statement for the Record  
Ways & Means Committee Hearing on  
**Reaching America's Potential: Delivering Growth and**  
Opportunity for All Americans

February 2, 2016

If Members of Congress wish to take true and meaningful action on policies to promote job creation and economic growth, they should act on bipartisan momentum for comprehensive tax reform. That means setting the corporate rate at 25 percent or less and closing the loopholes. American job creators face an uncompetitive tax code. That's why America desperately needs an overhaul of that code. Without reform to our uncompetitive code, we can expect continued corporate inversions and the loss of jobs and investment to other countries with fairer tax codes. Our foreign competitors are continuing to lower their rates leaving the U.S. at an increasing competitive disadvantage. And so the notorious phenomenon of "corporate tax inversions," for example, continues.

The answer to the question posed by the committee in today's hearing is clear if we look back to the Tax Reform Act of 1986. By lowering the rates and broadening the base, that piece of bipartisan legislation brought about two full decades of steady economic growth.

It really happened, not only in the 80s, but also in the 60s, and with the enthusiastic support of both parties. Indeed, we can look back at that era, from roughly 1962 to 1986, and see a time when both parties were on board. If we are willing to learn the lessons of that era, including the way that each party chose to view tax-rate reductions, then there's hope, even in this era of rancorous partisanship for achieving something great for the American people.

Yet if we really do want to return to those good old days, we need first to remember the ideas that brought the two parties into agreement. It wasn't that they saw eye-to-eye—not at all. Then as now, they had divergent visions, and yet back then, they were nevertheless able to align their differences into a single legislative package. That was the art, one might say, of that era.

So what were these two visions? In a nutshell, Republicans saw tax-rate reductions as a boon to the private economy. That is, workers, savers, and investors would see more money; they would enjoy, in the parlance, a higher after-tax return.

By contrast, Democrats saw tax-rate reductions as a boon to the public economy. To be sure, Democrats agreed that tax cuts could stimulate the private economy, but that wasn't their main goal. Their main goal was for the government to have more money to spend.

The champion of this sort of thinking was John F. Kennedy. In 1960, Kennedy had campaigned for the White House on a pledge to "Get the country moving again." And by that he meant that Uncle Sam should do more—more to fight communism abroad, more to fight poverty at home.

In other words, JFK's vision was primarily a public vision: He wanted the government to have more money to do more things. So on December 14, 1962, when he said, in a speech to the New York Economic Club, "It is a paradoxical truth that tax rates are too high today and tax revenues are too low," he meant exactly what he said—rates too high, revenues too low. Yet Kennedy was shrewd enough to see that lobbying for a simple tax increase would be counter-productive, and probably not politically feasible. He took a more complex route to his goals; he embraced the "paradox," as he called it, that lowering tax rates would yield higher tax revenue.

Yes, in Kennedy's mind, the government needed more money. As he spoke at the Waldorf Hotel in Manhattan in 1962, the 35th President wasn't worried that savvy New York City investors would fail to see the advantage to them in lower tax rates. Instead, his message was bigger and broader, aimed at the larger national audience that might not have been as alert to the variables of marginal taxation and after-tax return.

Indeed, to get a better sense of Kennedy's argument in that era, we might consider what is probably his best-known quote about the economy: "A rising tide lifts all boats." We can note that those words were said in a speech delivered in late 1963, as he lobbied once more for the tax-rate reduction. (Those tax cuts would not, in fact, occur in Kennedy's lifetime; they were not enacted until 1964—then, as now, Congress moved slowly.) Yet because JFK's words about a "rising tide" were uttered during his tax-cut campaign, it is often assumed that this rising tide had something to do with tax cuts. And in a way, they did—but only in a paradoxical way, only indirectly. As we shall see, Kennedy was referring, specifically, not to the positive impact of tax cuts, but to the positive impact of spending increases—yet gained, to be sure, by those very same cuts.

On October 3, 1963, JFK traveled to Heber Springs, Arkansas, to dedicate the Greers Ferry Dam. In his remarks that day, he was at pains to delineate the public benefits of public-works projects: "A rising tide lifts all the boats, and as Arkansas becomes more prosperous so does the United States."

That is, Americans didn't have to calculate their after-tax return, nor did they need to trust, in any way, the "magic of the marketplace" to see the benefit of his policies. Instead, thanks to greater prosperity and greater revenues, all they had to do was look out their window and enjoy the many benefits of their new dam.

And that was Kennedy's bold idea. He himself was fully aware of the stimulatory effect of tax cuts, but what he wanted to sell, especially to his fellow Democrats, was the benefit of that stimulus—higher tax revenues that could be spent on public works, such as the Greers Ferry dam.

One Republican who agreed with Kennedy was another JFK: Jack F. Kemp. Kemp, born in 1935, was very much a member of Kennedy's New Frontier generation. And so, in the 70s and 80s, it was easy for Kemp, a "supply side" Republican, to say that the purpose of tax-rate reductions was to give more to workers, savers, and investors. That was the Republican message. And yet at the same time, Kemp could say, echoing JFK, that the goal was also to generate more tax revenue for social programs. That was a message that spoke to Democrats and made Kemp such an important "crossover figure" and bipartisan bridge-builder. And so such staunch Republicans as Ronald Reagan, and such staunch Democrats as Lloyd Bentsen, both became persuaded by Kemp's way of thinking, which, as we have seen, was tried-and-true, even as it was fresh.



Many Republicans came to regard Kemp as a “big government” conservative, and in the minds of some, that jibe was justified. However, he was the intellectual champion of the two great tax-rate reductions of the 80s, in 1981 and 1986.

Thus we can see, at the risk of overusing the word, a further “paradox”: Tax-rate reductions, as Kennedy and Kemp foresaw in their different eras, would so stimulate the economy that revenues would increase as well. And that was good news for Democrats, even those who mistrusted the private sector. Meanwhile, Republicans, who mistrusted the public sector—and thus wouldn’t want the government to have more money—would have to make a calculation: Did their affection for private economic growth exceed their hostility toward an enlarged public sector?

During the Reagan years, everything came together—for both parties. Federal revenues soared, from \$617 billion in fiscal 1982 to \$991 billion in fiscal 1989, and yes, this revenue-surge happened even as the top personal tax rate was cut from 70 percent to 28 percent and the corporate tax rate from 46 percent to 34 percent. So was this a victory, or a defeat, for Republicans? To Reagan and Kemp, it was undeniably a victory, because real GDP rose by more than a third in that era. But many Democrats had voted for the ’81 and ’86 tax reforms as well, and for them, too, it was a victory: After all, federal spending rose by more than half during the Reagan years.

As we have seen, in that golden quarter-century, 1962 to 1986, both parties preferred to go with their hopes, not their fears. They voted, together, for growth.

We hope that this Congress agrees that we need that same spirit of bipartisan problem-solving today.

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