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UNLEASHING AMERICA'S ECONOMIC POTENTIAL

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

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UNLEASHING AMERICA'S ECONOMIC POTENTIAL

WEDNESDAY, APRIL 11, 2018

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to call, at 2:17 p.m., in Room 216, Hart Senate Office Building, the Honorable Erik Paulsen, Chairman, presiding.

Representatives present: Paulsen, Handel, Delaney, LaHood, Maloney, and Beyer.

Senators present: Heinrich, Peters, Cruz, Klobuchar, and Lee.

Staff present: Theodore Boll, Colin Brainard, Gerardo Bonilla, Daniel Bunn, Kim Corbin, Barry Dexter, Alaina Flannigan, Connie Foster, Natalie George, Colleen Healy, Matt Kaido, Kwabena Nsiah, Allie Neill, and Alex Schibuola.

OPENING STATEMENT OF HON. ERIK PAULSEN, CHAIRMAN, A U.S. REPRESENTATIVE FROM MINNESOTA

Chairman Paulsen. We will call the hearing to order. Good afternoon, and welcome to the hearing on "Unleashing America's Economic Potential."

For the eight years prior to this new Administration we were told that America could never do better than two percent growth. We were told that such sluggish growth was the new normal, and that we had to lower our expectations. And this contradicted what we knew about America.

We all know America is an economic powerhouse, and we are blessed with vast and bountiful land, massive energy resources, and most importantly the American people.

Our dreams as a Nation do not rely on government fiat or foreign influence, but on the resourcefulness, the innovativeness, and the hard work of everyday working Americans. And the question is: Will we as elected officials of the U.S. Government allow them to work towards their dreams and fully contribute to our Nation's prosperity? And this hearing is just about that.

How is it, for instance, that we have just seen a remarkably good job growth for the last few months? Listen to these numbers: We are averaging 214,000 more jobs for February and March, and the employment-to-population ratio has held steady.

The unemployment rate has remained stable at 4.1 percent for six months, the lowest since 2000. And, meanwhile, average hourly earnings continue their upward trend. And it was not long ago we

were told not to expect this. In fact, we were told to lower our expectations—and I will explain.

As an example, when my daughters set goals, these goals are generally beyond where they are at the current time. Maybe they want to get better at math or science. Maybe they want to read more books than before. But the point is, they know their potential, and they set goals beyond where they are currently at because they want to grow. And it should be the exact same when we are thinking and talking about our own economy.

The first graph that was displayed at our last hearing, the top line is what the Congressional Budget Office thought in 2007 our economy was capable of producing. This is an economy of hope and growth. The bottom line, regrettably, is what our economy in fact produced, our actual real GDP.

Now to be sure the financial crisis knocked us off our feet. The lines in between are the annual CBO forecasts of our economic potential over the course of the Obama administration. In each year, these forecasts were lowered year by year. This is what it looks like when a Nation is urged by its leaders to accept mediocrity and to let the government handle more.

More taxes, more regulations, and more control meant that the American economy was being held back. This was a self-fulfulling prophesy. These projections dragged under a growing weight of high tax rates and record-setting levels of regulation.

Before 2017, economic growth was slow, employers were not willing to invest in their businesses or their employees. Productivity and take-home pay had stagnated. People in their prime working years stayed out of the workforce, and fewer people were willing to risk starting a business, so entrepreneurship fell.

Businesses found it more attractive to invest and create jobs overseas, where other countries had learned to lower their corporate tax rates and reduce regulations. And at the same time, the Federal Government's power over nearly every aspect of our lives grew.

And, yes, there are constructive things that the government does such as keeping us safe, enforcing civil and property rights, and setting rational "rules of the road" by which the economy could operate efficiently. However, government does not create prosperity. Our people create prosperity by having great ideas, working hard, and having the resources to take a risk on building a piece of the American Dream.

Far too often government stands in the way of prosperity and opportunity by over-taxing and over-regulating. A country's GDP is based on its workforce, capital stock, and productivity determined by technology, innovation, and training.

It is not based on how much the government succeeds in redirecting capital. And we are seeing a different course that lifts the artificial constraints that government has imposed on the economy.

This graph is similar to the one in the Report the JEC published last week in response to The Economic Report of The President. If we lift the government constraints of high taxes and heavy regulation that weighed down our potential, our economic potential can rise.

If it rises to what CBO projected as recently even as 2012, there would be plenty of room displayed as the output gap for our economy to grow faster. We have removed the government obstacles that prevented Americans from achieving their dreams.

When growth is strong, businesses have the confidence to invest, jobs are plentiful, potential entrepreneurs become willing to risk starting a business, and American households become more prosperous. And we are already seeing results: every quarter of economic growth in 2017 outperformed the same quarter in 2016; business investment is strengthening, and small business confidence is high; production and investment are coming back to the United States; paychecks are growing because the government is taking a smaller cut and businesses are investing in their workers.

In my home State of Minnesota, the good news about tax reform keeps pouring in as companies like BestBuy, Bio-Techne, CIT Relay & Switch, LORAM, Data Sales, DTN, Hormel, TCF, and U.S. Bank—and there are others—invest in their employees by giving them special bonuses, pay raises, or additional better benefits.

But even with the tail winds of pro-growth tax and regulatory reform, there still are risks to the economy such as the newly announced tariffs. Trade is critical to our economic growth. A robust trade agenda is essential for the United States to grow jobs by selling American goods and services around the world, as 96 percent of the world's consumers live outside of the United States.

The end goal of trade policy should be to eliminate artificial barriers for the free flow of our goods and our services, not cause new ones. And I look forward to hearing from our distinguished panelists who are here today as they advise us on other ways to unleash great opportunity in America.

And before I introduce them, I now recognize our Ranking Member, Senator Heinrich, for his opening statement.

[The prepared statement of Chairman Paulsen appears in the Submissions for the Record on page 34.]

OPENING STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, A U.S. SENATOR FROM NEW MEXICO

Senator Heinrich. Thank you, Chairman. I am pleased that we have this opportunity today to dig a little deeper into the Republican tax law.

It was a complex bill, passed without Democratic input and very little debate. The result is a hastily written law that has caused confusion about how families and the broader economy will be impacted.

So let me start with a couple of facts.

As a result of the Republican tax law, working families will see what little relief they get disappear over time. Corporations will pocket massive permanent gains. The deficit will soar, and Republicans will point to spending as the problem. And the price tag seems to be growing.

From $1.5 trillion in December, this week CBO increased the estimate to $1.9 trillion. By adding nearly $2 trillion to the national debt, the tax law gives Republicans a fresh rationale to target Social Security, Medicare, and Medicaid. Before the bill was even signed, Speaker Ryan said, quote, "We're going to have to get back

next year at entitlement reform, which is how you tackle the debt and the deficit." End quote.

And other House Republican leaders, including Majority Leader McCarthy and Majority Whip Scalese, have made similar pledges to do the same. I thought a big part of tackling the debt and the deficit was not wasting nearly $2 trillion on tax breaks for large corporations and wealthy individuals. But that is not how my Republican colleagues see it.

To pay for some of their tax giveaways, Republicans want to cut health care coverage that families receive through Medicaid, and go after Medicare and Social Security that seniors and their families count on.

Let me be clear. Democrats will fight these cuts every step of the way. This week House Republicans are planning to vote on a so-called "Balanced Budget Amendment" that would have devastating consequences for seniors, children, and middle class families.

It is all part of the same Republican script. Tax breaks for those who do not need them, followed by a belated call to address the national debt they keep adding to. As this Committee has discussed, Republicans also promised that their tax law would result in big yearly wage increases of $4,000 per family, to be precise.

Now there is no question that families across the country desperately need a raise. After adjusting for inflation, the typical worker's wages have grown by only 6 percent over the past 35 years.

It is especially tough in places like New Mexico where there are fewer jobs today than when the Recession began more than a decade ago. And the unemployment rate is at 5.8 percent, almost 50 percent higher than the national rate. But the ones who are getting most of the benefits from the tax law are corporate executives and wealthy shareholders.

Companies are spending about 30 times as much on stock buybacks as on worker bonuses or wage increases. Why are large companies using their tax savings to lift their stock prices?

Well, it is actually pretty simple. Executive compensation is tied directly to the price of company stock. One study found that more than 80 percent of compensation of the 500 highest-paid executives in 2015 came from stock. That is a pretty big incentive for top executives to try to get their stock price higher.

And there is another piece that is just as concerning. Large buybacks also mean that companies have less left over for investment in factories, in research and development, all of which drive productivity, job creation, and wage increases over the long term.

Now I want to turn to the other focus of today's hearing: reversing critical Federal oversight.

The Administration has rolled back protections for workers, for consumers, and for the environment. Reducing cost is often the stated motivation behind gutting protections, but a new OMB report shows that the regulations issued between 2006 and 2016 resulted in annual benefits that far exceeded the costs, benefits of between $287 and $911 billion with annual costs of between $78 and $115 billion.

Now there is no question that many recent actions taken by the Administration will harm workers and consumers. For example,

the Trump Administration reversed an increase in the overtime threshold, costing 4 million workers a collective $1.2 billion in additional wages per year.

The Administration has given payday lenders a green light to engage in predatory lending practices that result in annual interest rates as high as 600 percent, and Republicans passed a law that reduced the effectiveness of the National Instant Criminal Background System and actually made it easier for people with serious mental illness to buy a firearm.

The Administration has also gone after the environment and our public lands. And at the end of last year, President Trump took action to dramatically reduce the size of Bears Ears and Grand Staircase-Escalante National Monuments, pushing aside concerns voiced by Tribal communities that these sacred places should be protected and opening up our wildest lands to commercial development.

The Organ Mountains-Desert Peaks and Rio Grande Del Norte National Monuments in New Mexico have also been under threat, despite widespread local support for their creation.

Rather than working off a special-interest wish list, the Administration should work with Democrats to foster inclusive economic growth that helps families pay their bills, afford to go to college, and save for retirement.

Thanks to each of you for your testimony today.

[The prepared statement of Senator Heinrich appears in the Submissions for the Record on page 38.]

Chairman Paulsen. With that, we will introduce our witnesses, and we will start—I will go through all four witnesses—Dr. Douglas Holtz-Eakin is the President of the American Action Forum. He also serves as a Commissioner on the Congressionally-chartered Financial Crisis Inquiry Commission, and an outside advisor to the U.S. Chamber of Commerce. During 2007 and 2008 he was the Director of Domestic and Economic Policy for the John McCain Presidential campaign. From 2003 to 2005, he was the sixth Director of the Congressional Budget Office, addressing the 2003 tax cuts, the Medicare Prescription Drug Bill, and Social Security reform.

Dr. Holtz-Eakin was also the Chief Economist for the President's Council of Economic Advisers from 2001 to 2002. He holds a Ph.D. in Economics from Princeton University, and a Bachelor's in Economics and Math from Dennison University. Thanks for being with us today.

Dr. Chad Moutray has served as Chief Economist for the National Association of Manufacturers since 2011. From 2002 to 2010 he was the Chief Economist and Director of Economic Research for the Office of Advocacy at the U.S. Small Business Administration. Prior to working at the SBA, he was the Dean of the School of Business Administration at Robert Morris College in Chicago, now Robert Morris University of Illinois. Dr. Moutray is a former Board Member of the National Association for Business Economics, and he is the former President and Chairman of the National Economists Club. He holds a Ph.D. also in Economics from Southern Illinois University at Carbondale, and Bachelor's and Master's Degrees in Economics from Eastern Illinois University.

And we also have a Minnesotan with us here today. Mr. Richard Hampton is the Chairman of the Board of Circuit Interruption

Technology, Incorporated, CIT. It is a family owned business in Minnesota his son Jeffrey founded in 1999, as well, and manages now as CEO.

Welcome to Washington. Mr. Hampton began his career as Materials Manager for Weatherford Company, a California-based electronic distributor, and later became President of Fisher Brownell, a leading switch distributor. He subsequently served as General Manager of Karoff Electronics, a leading electronic components parts distributor based in Minnesota. And prior to joining CIT, he was Vice President, National Sales Manager, and President of Electronic Components Group.

And our fourth witness today is Dr. Jay Mazur, as Vice President for Tax Policy and the Robert C. Pozen Director of the Urban-Brookings Tax Policy Center. From 2012 until early 2017, he was the Assistant Secretary for Tax Policy at the U.S. Department of the Treasury. Dr. Mazur served in the Federal Government for 27 years in various positions, including Senior Economist at the President's Council of Economic Advisers, Senior Director at the National Economic Council, Acting Administrator of the Energy Information Administration, and Deputy Assistant Secretary for Tax Analysis in the Office of Tax Policy. Before entering public service, Mazur was an Assistant Professor in Hines College at Carnegie Mellon University. He also holds a Ph.D. in Business from Stanford University.

And with that, we will welcome each of you to the Committee today, and we will begin with Dr. Holtz-Eakin. And we'll just remind all witnesses to limit your testimony to five minutes, and we are looking forward to hearing from you.

Dr. Holtz-Eakin.

STATEMENT OF DR. DOUGLAS HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM, WASHINGTON, DC

Dr. Holtz-Eakin. Thank you, Mr. Chairman, Ranking Member Heinrich, and Members of the Committee. It is a privilege to be here today.

In my oral remarks I will make three very straightforward points, and then I look forward to your questions.

As of January first, 2017, poor economic growth was the top domestic problem facing the United States. Since then, the tax and regulatory changes I think will be quite beneficial for the growth environment, but my third point would be that there are challenges that remain and more work to be done. So let me elaborate on those.

From the end of World War II to 2007, the U.S. economy grew rapidly enough that, even with the arrival of the Baby Boom population, income per person, GDP per capita, doubled roughly every 35 years. And so in one working career one could see the standard of living roughly double, and that was America's route to whatever their version of the American Dream.

Since then, all projections were that the economy would grow roughly 2 percent, as the Chairman mentioned, and that with population growth this meant that the income per person would double roughly every 70 years. So access to the American Dream was twice as far away.

In 2016 the American economy did not even do that well. The Census data revealed that for those households that worked full-time for the full year, they saw zero increase in their real income. So we entered 2017 with a severe growth problem, in my view.

I think there have been some very beneficial changes on that front. During the eight years of the Obama administration the Federal Government finalized the costly regulation at a rate of roughly 1.1 per day every day, and the total self-reported cost by the agencies of complying with those regulations was $890 billion. So every year for eight years over $100 billion in new regulatory costs were added to the economy.

I think there is little doubt that that has harmed the growth potential. Since President Trump has been inaugurated to the end of Fiscal Year 2017, the addition to that total is exactly $5 billion. And the commitment in the President's budget is that in Fiscal 2018 there will be a reduction of $9 billion in the overall regulatory costs.

Now there is no real science on exactly what the magnitude of the impact that will be on economic growth, but I think directionally it has to be going in the right direction. I think it is going to contribute to the capacity to start up small businesses, and to have expansion of those businesses in the U.S. economy.

The second major event in 2016 was the passage of the Tax Cuts and Jobs Act. And the business provisions of the U.S. Tax Code prior to that law sent the very straightforward message to our most successful global companies. They said, if you've got some valuable intellectual property, park it abroad. Maybe park the production over there as well. Certainly if you make any money, keep it over there. And if circumstances arise where you might be merging—merging with someone or acquiring a company, move the headquarters as well.

And so all the messages were to invest and innovate outside the United States. The Tax Cuts and Jobs Act, with the reduction of the corporate 21 percent, the movement toward a more territorial system, the imposition of a patent box for the global returns to intellectual property, and the expensing provisions send a different message. It sends a message that says: Invest. Innovate. Hire. And expand in the United States. And I think that is an incredibly valuable improvement in the business climate on something that will benefit productivity growth, capital per worker, and ultimately real wages in the United States.

But—and we have seen, for example, the CBO credit that in their most recent report where they talked about the improved incentives to save, invest, and grow in the U.S., and more beneficial growth in 2018 and 2019.

The challenges that remain are I think really budgetary and the concerns I've shared with the Chairman about our trade and our immigration strategies at the moment.

The budgetary ones, as a former CBO Director, trouble me the most. I think the CBO outlook should be a wake-up call to everybody. There is an enormous amount of red ink, not way out there but right in front of us, and it needs to be dealt with. It is not a pro-growth strategy to sail directly into a sovereign debt crisis. And the current trajectory is exactly that. It is not a matter of "if," it

is "when" does the U.S. get in trouble? And so we need to deal with the fact that these entitlement programs are growing at rates that are unsustainable. Medicare is 7.3 percent. Social Security is 6.3. Affordable Care Act is 6. Medicaid is 5.2. There is not a tax code that is going to deliver that kind of revenue growth year over year for the foreseeable future. So we need to reform those programs.

We need to reform them for their beneficiaries, as well. Those are not financially sustainable. It is a tragic irony that our social insurance system is now delivering risk to its beneficiaries. And I would urge the Congress to fix that.

So I will be happy to answer your questions or elaborate on my concerns with the other challenges that face us, but I believe progress has been made, but the job is far from done.

[The prepared statement of Dr. Holtz-Eakin appears in the Submissions for the Record on page 40.]

Chairman Paulsen. Thank you, Dr. Holtz-Eakin. And, Dr. Moutray, you are recognized for five minutes.

STATEMENT OF DR. CHAD MOUTRAY, CHIEF ECONOMIST, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Dr. Moutray. Thank you. Chairman Paulsen, Vice Chairman Lee, Ranking Member Heinrich, and Members of the Joint Economic Committee, thank you for the opportunity to testify on The Economic Impacts of Tax Reform.

Last fall, President Trump came to the NAM, the National Association of Manufacturers, the voice of 12.6 million men and women in America, and he referred to tax reform as rocket fuel for the economy.

Our members could not have agreed more. The NAM's latest quarterly outlook survey released in December showed a manufacturing sector with optimism levels at unprecedented heights, 94.6 percent of respondents saying that they felt positive about their own company's outlook, the highest in the survey's 20-year history.

And while I cannot get into specifics right now, we will be releasing the next quarterly survey very shortly—hopefully, very soon. Much of this is due to the fact that tax reform passed. And even in anticipation of the tax reform actually getting enacted, manufacturers were energized as we have not seen them in a long time.

It is little wonder, then, given that tax reform achieved so many of the NAM's long-sought goals, that we are seeing such levels of optimism. Those goals are, as just a reminder:

Lowering the marginal tax rate so U.S. manufacturers can compete globally; reducing the burden on many small businesses, small and medium sized manufacturing companies, which account for more than 90 percent of NAM members; moving us towards a territorial tax system, much like the rest of the world; encouraging more dollars to flow back into the United States; and expanding fixed investment and incentivizing more private-sector R&D.

Of course there are additional tax changes that could have supported the—will continue to support the manufacturing sector even further. And of course there are other factors underlying manufacturing optimism as well, such as a global economy and other regulatory policies.

I will expand, obviously, on much of this in my written testimony, but let's not bury the lead. Washington delivered with pro-growth tax reform, and it is already starting to make private-sector businesses much more competitive. Private-sector businesses are already starting to deliver, as well. They are creating more well-paying jobs. They are putting more money in workers' pockets. They are investing more in their businesses, and the economy.

Nearly every day we see more positive stories that underline these things anecdotally. Here are a few examples from NAM members:

Thanks to tax reform, Miles Fiberglass of Oregon recently raised its entry-level wage by 9 percent, gave all of its employees a pay bump, and plans to nearly double the size of its workforce. It is also using tax reform savings to design a new facility that will cut back on waste and increase energy efficiency.

Thanks to tax reform, Centennial Bolt in Denver will increase its workforce by nearly 50 percent, and open a new plant in the Midwest. The company already gave a Christmas bonus to all of its hourly workers, totaling about 5 percent of their annual pay, and is currently planning another mid-year bonus as well as increases to their employees' profit-sharing program.

Thanks to tax reform, Wyndham Millwork in Wyndham, Maine, is planning to increase its workforce by 20 percent, and start a $1 million expansion of its facility. It also gave an immediate bonus of $1,000 to hourly workers, and across-the-board pay increases that the company describes as a direct result of tax reform. The NAM of course continues to highlight this and many other stories on its blog site, Shopfloor.org, and will continue to do so in the coming weeks. The NAM is also in the process of surveying its membership on the impacts of tax reform, and we will release the findings of that analysis in the coming days. But for now, let me share with you my predictions as an economist about what we might be able to expect on the manufacturing sector.

I believe tax reform should lead to manufacturing investments rising by $55 billion in 2018, an increase of 11 percent compared to last year. I also believe that tax reform should lead to manufacturing employment rising by more than 100,000 this year, also a substantial increase especially when you consider that the sector added 207,000 workers in 2017, and that was a banner year.

We have already added 73,000 workers so far this year through the first three months. This is all based on a model that I have been working on to predict the impacts of tax reform. More broadly, I believe that the U.S. economy should expand this year at its fastest rate since 2005 at 3 percent.

While manufacturers should benefit from stronger economic growth globally, it is clear that businesses are responding positively to the passage of pro-growth tax policies. The NAM will continue urging manufacturers to take further positive steps on jobs, benefits, and investments, just as we have continued urging the President and Congress to look for additional ways to enhance competitiveness and to lift up more Americans. That I know is also the goal of this Committee. Thank you.

[The prepared statement of Dr. Moutray appears in the Submissions for the Record on page 55.]

Chairman Paulsen. Thank you, Dr. Moutray.

Mr. Hampton, welcome, and you are recognized for five minutes.

STATEMENT OF MR. RICHARD HAMPTON, CHAIRMAN OF THE BOARD, CIRCUIT INTERRUPTION TECHNOLOGY, INC., ROGERS, MN

Mr. Hampton. Chairman Paulsen, Ranking Member Heinrich, and Members of the Committee, thank you for this opportunity to testify on Unleashing America's Economic Potential through the perspective of one small Minnesota business.

My name is Rick Hampton. I am Chairman of the Board of Circuit Interruption Technology, Incorporated. CIT was started in 1999 by my son after he had graduated from the Metropolitan State University Business School. Jeff is with me today. Jeff is President and CEO of the company. My wife, Sharon, is Chief Financial Officer; my daughter-in-law Jennifer Hampton handled CIT accounting since its inception and my daughter, Nicole, who is a businesswoman in her own right, handles international distribution and sales management.

We now conduct business as CIT Relay and Switch. And in the past four years expanded from 12 to 22 employees. There are virtually no relay and switch manufacturers in the United States today, so we contract with manufacturing facilities in China and Korea.

Many of our customers are household names, using our relays and switches in countless products. When, for example, you send your children off to school on a yellow bus, start your dishwasher, set your thermostat, drive a golf cart, even mix your favorite health drink at home, it's very likely you are using CIT product today.

As earlier noted, Jeff launched the business in 1999 in our home using $50,000 he had saved from his college years' landscaping business. I cashed in my 401K. My wife and I borrowed $80,000 in credit cards, and mortgaged our home. For two years, none of us received an income.

Over the years, we shared equally the profits from our work with State and Federal taxing authorities. Prior to the new December tax bill, the high average tax on CIT product led to a less-than-desirable business approach.

To avoid double taxation where the value of one dollar might easily shrink to thirty-five cents, our CPA advised the best approach would be to take 100 percent of the profit out of the business, subject them to a one-time personal tax burden, roughly 50 percent State and Federal. The resultant reinvested dollars, however, were seen by bankers as a liability, not retained earnings, thus impairing CIT's credit standing.

Tax reform has changed our business model. We immediately provided a bonus of one extra week's pay to all employees. This took place around Christmas. We provided raises to all of our employees. We funded our 401K program at a full 5 percent of their 2017 income with no employee match required.

We launched a $140,000 lab and facilities' construction program which is in process as we are here today. We increased our employee base by 10 percent, with plans for another 10 percent by year's end.

Due to the new law, after-tax profit of the 79 percent remaining will now be retained directly in the business. That is a whopping 79 cents on every dollar after tax, jet fuel for a business like CIT.

Tariffs. Let me insert a word or two about what we apprehend as possible unintended consequences in the proposed tariff on relays in particular. An exclusive China tariff will provide a corresponding 25 percent competitive advantage to manufacturers located in Mexico and in Canada. And, yes, even state-owned facilities in China who are often reimbursed for such expense, thus inadvertently punishing domestic companies like CIT.

In conclusion, tax reform has been and will continue to be a tremendous help to our business and employees. We will hire added staff this year, expand new products, and explore the costs of reshoring manufacturing. However, we continue to be very apprehensive about regulations.

I believe the lower tax will allow CIT Relay & Switch to position itself for even greater growth for the coming decade.

More might be done, but this historic change has energized the entire CIT team, employees and management alike.

Thank you again for this opportunity to testify, and I look forward to any questions.

[The prepared statement of Mr. Hampton appears in the Submissions for the Record on page 63.]

Chairman Paulsen. Thank you, Mr. Hampton.

Mr. Mazur, you are recognized for five minutes.

STATEMENT OF HON. MARK MAZUR, Ph.D., THE ROBERT C. POZEN DIRECTOR OF THE URBAN-BROOKINGS TAX POLICY CENTER, WASHINGTON, DC

Dr. Mazur. Great. Thank you, and good afternoon. I would like to start by thanking Chairman Paulsen, Ranking Member Heinrich, and Members of the Committee for inviting me here today.

I think it is crucially important for the Congress to focus on the economic trajectory of the country. I want to emphasize that, while I am Director of the nonpartisan Urban-Brookings Tax Policy Center, I am here testifying on my own behalf. The views I discuss are my own and should not be attributed to the Tax Policy Center, Urban Institute, or Brookings Institution.

Given my background, I am going to focus on the recently passed Tax Cuts and Jobs Act, the most significant tax overhaul in the last 30 years.

The new law does a lot of things. It makes some major structural changes in the way that multinational firms are taxed, in the way that pass-through businesses are taxed. It contains dozens of less structural changes: removal of a number of tax expenditures and some income exclusions, cuts rates by a third for corporations and more modestly for individuals. And all of these changes will have implications for the economy.

But as a starting point for evaluation, I would like to consider four basic tenets of good tax policy:

First, revenue adequacy. That a tax system should raise enough revenue to pay for the goods and services that the public demands.

Second, it should be an efficient tax system. There should be as little in the way of negative effects on resource allocation, economic behavior, economic growth prospects.

Third, a tax system should be equitable. There should be horizontal equity in that similarly situated taxpayers get treated about the same. And there should be vertical equity in that taxpayers with the greater ability to pay should contribute a higher portion of their income to the country.

And last, a tax system should be simple. There should be a simplicity component. It should be designed so individuals and businesses know what the consequence of their behavior are, and are able to take that into account ahead of time. And the tax system should be clear, comprehensible, and predictable.

Now in the real world all these goals involve tradeoffs, but it is possible, though, to keep these goals in mind to at least evaluate what is going on with the tax system.

There are some clear effects of the Tax Cuts and Jobs Act. First, the revenue effects. It is a big tax cut. It is a big economic stimulus in the short term, approximately $130 billion in this fiscal year, double that in the next year.

Second, distributional effects are pretty clear. The tax benefits are tilted to higher income households. The bottom 20 percent of the income distribution gets on average about $60 a year, four-tenths of a percent of their after-tax income. The top 20 percent gets benefits in excess of $7,600 a year, a little over 2 percent of their after-tax income.

Third, there is a temporary nature of these tax cuts. Individual components generally are temporary. The investment incentive is generally temporary. The corporate tax cuts and the structure of the way multinational firms are taxed are permanent.

The way multinational firms are taxed is quite different under the Tax Cuts and Jobs Act. It brings the U.S. much more in line with our trading partners, moving us more toward a territorial system and away from a worldwide system with deferral.

There has been a lot of discussion about the economic effects of the Tax Cuts and Jobs Act. I think the conventional economic estimates seem to indicate that there should be a burst of economic activity, economic growth, in the short term but those effects dissipate over time as higher Federal budget deficits increase interest rates and provide a crowd-out for investment.

The Tax Cuts and Jobs Act will have a big impact on the fiscal position of the United States. If you look at the last 50 or 60 years of data, the U.S. has seen Federal revenues fluctuate between 15 and 20 percent of GDP. And in that time period, there have been two small periods of time when the Federal budget was balanced.

The most recent one was late 1990s, early 2000s, when revenues were around 20 percent of GDP. Given demographic trends, retiring Baby Boomers, longer life spans, lower birth rates, we can expect that demands for Federal goods and services will be 20 percent or more of GDP going forward.

And so the Tax Cuts and Jobs Act, by cutting revenues in the short and medium term, moves in the opposite direction of budget balance. And what this means is that the Tax Cuts and Jobs Act

really is a large fiscal experiment. The economy is near full employment, and we are in a big fiscal stimulus at this point in time.

Proponents of the Act say that there will be improved investment incentives that will lead to greater accumulation of capital, more productive workers, and eventually higher wages for the workers.

It is too early to tell at this point whether all those linkages will be realized, and what the strength of those linkages will be. Really, it will be months or years before we can tell whether the Tax Cuts and Jobs Act has had the intended effect. So the jury is out.

Congress will have opportunities to revisit this Act in the coming years as provisions expire or phase in our phase out, and there will be an opportunity to make any necessary changes.

So thanks for your attention. I would be happy to answer any questions you may have.

[The prepared statement of Dr. Mazur appears in the Submissions for the Record on page 67.]

Chairman Paulsen. Thank you, Dr. Mazur. And with that we will begin the question opportunity for all Members. I would just remind Members to keep their questions to five minutes.

I will begin. Dr. Holtz-Eakin, what are the most exciting parts of the Tax Cuts and Jobs Act in terms of boosting wages, jobs and investment in the United States? And what are the risks to the economy if major parts of the law are allowed to expire going forward?

Dr. Holtz-Eakin. So I would say the most important thing for the middle class would be to get real wages rising again. And the key piece there, as Dr. Mazur outlined exactly right, which is to get better innovation and capital accumulation, higher and better capital per worker. That historically has been strongly linked with higher compensation for those workers.

The key business tax reforms at the heart of the Tax Cuts and Jobs Act are the things that I think are most beneficial. They are the movement to a territorial system, a corporate rate that is now in line with our developed competitors; the expensing incentives. And the patent blocks, so that we no longer tell all of our corporations to park their most profitable inventions overseas. That I think is fantastic.

The pass-through provisions are intended to mirror those. Nothing is perfect. Everyone has their own quibbles with these things, but those are the core of the things that I think are most important.

I would just like to say, I think everyone who looks at this should have a little humility when they talk about the projected impacts. The United States has never before, and never again, will move from a worldwide to a territorial system of taxation. It is the largest, most successful economy on the globe. It is doing something unprecedented. And the idea that we have fantastic precision about the ultimate impacts I think really overstates the case.

I agree with the jury-is-out sentiment. I am looking at the data every month, and we will just see how big those linkages are and how fast they happen.

Chairman Paulsen. Dr. Moutray, we have seen some very encouraging signs in manufacturing, as you outlined. Can you please tell us a little bit more about some of the most important steps that

we can take to sustain the growing recovery of manufacturing here in America?

Dr. Moutray. Well I think number one we can continue to do what we have been doing, right? I think that the tax policy was a nice step in the right direction, but we need to continue to improve the tax policy, making some of those provisions permanent.

On the regulatory side, I think we also have continued a policy of enacting smart, very business-friendly policies, making sure we are looking not just at the overall impacts but looking at the impacts on small businesses, in particular. And, from manufacturers I think we just need to continue to make sure that the economy continues to grow and flourish, and we are certainly seeing that in manufacturing not just with the examples I gave earlier, but the number one issue right now with most manufacturers is the ability to attract and retain workers.

And this I think speaks to just how strong the economy is, and how strong the manufacturing sector is, and hopefully that leads to wage appreciation moving forward.

Chairman Paulsen. Would you say one of those components to attracting and retaining workers is what Dr. Holtz-Eakin had mentioned in his written testimony mostly about some immigration components and the importance of having a workforce that is entering those markets for manufacturing?

Dr. Moutray. I would definitely agree with that, and we certainly have supported that.

Chairman Paulsen. Good. Mr. Hampton, again welcome. Let me ask you this: In spite of how it provided massive tax relief to middle class Americans, we sometimes hear people characterize the Tax Cuts and Jobs Act as only mostly benefiting, and as a giveaway to the wealthy. But how would you respond to that? I mean, you know, from your perspective in your personal story?

Mr. Hampton. It is actually——

Chairman Paulsen. If you would, just hit your microphone there.

Mr. Hampton. It is actually somewhat the reverse of that. Before, we were forced into and to avoid double taxation, we were actually having to take money out of the business. As a result of the law, we are able to leave it in. We can leave in nearly 80 percent of the profit dollars because we are taxed at 21 percent. Before, to avoid the potential for double taxation, we removed 100 percent of the money from the business, took a personal tax on that money, and then reinvested the 50 percent back into the business.

So actually it is going to improve our situation, and that is why I say this year we will begin every year leaving the money in the business, into retained earnings. That allows us to make investments in additional personnel, and so forth, particularly in the engineering and technical side, for the exploration into possibly reshoring manufacturing, which this country desperately needs, particularly in the product that we supply, as we supply product even for aircraft carriers and it is made in China.

It makes no sense. We need to build it here.

Chairman Paulsen. So it sounds like with some of the retained earning provisions, or success of the new law you talked about, do you see the track record continuing on the same parallel of, you

know, you gave some special bonuses, you gave pay raises, you contributed to the 401K, do you see that same path forward if there are no interruptions to sort of current tax policy?

Mr. Hampton. Our current plan with the tax policy is that we indeed will be funding again this year a full 5 percent for our employees. And by the way, that is 100 percent their money. We don't say that you've got to serve so many years. As soon as we give it, they own it. And that means 100 percent of what we have in 401K, those people own. We do not own it.

And we will continue with that. We also plan to do another bonus, full week's bonus, this year. We are adding additional employees. So I think most of these programs will definitely continue forward.

Chairman Paulsen. Thank you.

Ranking Member Heinrich, you are recognized for five minutes.

Senator Heinrich. Thank you, Chairman. I appreciate it.

Dr. Holtz-Eakin, you said that we need to reform entitlements. And one of the interesting things I find is that I have never had a constituent come up to me at a meeting and ask me about their "entitlements," or talk to me about their "entitlements." They usually talk to me about Social Security and Medicare.

And it makes me wonder if the difference isn't that it polls a lot better to say "reform entitlements" than it polls to say "you should cut my Social Security."

So I want to ask you about that reform. When we talk about reforming Social Security, in your view should that include reducing benefits for some workers in their retirement years?

Dr. Holtz-Eakin. My major concern with Social Security is that the Trust Fund that exhausts under current projections is roughly 13 years. And people in retirement will have their benefits cut by 25 percent across the board. And I think that is a disgraceful way to run a pension program.

Senator Heinrich. You are assuming those cuts are going to happen, but you are saying——

Dr. Holtz-Eakin. Under law, they would happen.

Senator Heinrich [continuing]. We should cut benefits now under current——

Dr. Holtz-Eakin. I didn't say that.

Senator Heinrich [continuing]. In order to not get to the point where those——

Dr. Holtz-Eakin. No, I didn't say any of that. I said the program needs to be addressed.

Senator Heinrich. So how would you suggest we reform that program? Should we look at reducing the—or increasing the retirement age?

Dr. Holtz-Eakin. I think that's sensible. That won't get you very much. That makes a small contribution to the fiscal sustainability of the program. There's going to be a combination of——

Senator Heinrich. So we are back to benefits?

Dr. Holtz-Eakin. I think there's no way that we can deal with Social Security, which is growing at 6.2 percent per year, and revenues which are going to grow at something that's roughly the rate of the economy——

Senator Heinrich. What if we increase the cap——

Dr. Holtz-Eakin. It is a one-time increase. You have a sustained, long-term problem of rapid growth in benefits that is faster than revenue.

Senator Heinrich. I just find it ironic that, you know, we look back in 2001 and 2003, when you oversaw the CBO, the Bush administration added $1.5 trillion to the deficit. Now my Republican colleagues have added another $1.9 trillion to the deficit. And we always look to people on Social Security and Medicare to pay for this.

I don't find that to be a credible solution.

Dr. Mazur, I want to ask you—and I am not going through again the faults of the national debt being added through this tax code, but this week we have seen the House preparing now to vote on a so-called balance budget amendment.

What impact would a balanced budget amendment have specifically on Social Security, on Medicare, and on Medicaid?

Dr. Mazur. Well it's hard to say without seeing the details of how the amendment would be implemented. But it seems to me like a balanced budget amendment, it's kind of an abdication of responsibility from Members of Congress because really it's their job to be fiscally responsible. You shouldn't need a constitutional amendment to tell you to do your job.

Senator Heinrich. People at home are shocked by what you have to say there.

[Laughter.]

Dr. Mazur. Sorry.

Senator Heinrich. If you look at that specifically from how you are able to address an economy when you fall into a recession, how would it affect the Federal Government's ability to respond to a recession and get an economy moving again?

Dr. Mazur. It would very much hamstring it. I think if you look at what happens at the State level where you have a balanced budget amendment, revenues go down during an economic downturn and you respond typically by cutting expenditures.

In the Federal Government, we have automatic stabilizers, increased unemployment benefits and the like, that allow you to kind of cushion the downturn. And I think we saw in the Great Recession the value of having those automatic stabilizers. It really did put a floor under the economy.

Senator Heinrich, You mentioned in your testimony that higher deficits can cause interest rates to increase, and certainly if we see a $2 trillion increase in the deficit that is not inconsequential.

We saw higher rates in the CBO's projections released on Monday. How will higher interest rates affect the costs that consumers bear through things like car loans, and in particular home mortgages?

Dr. Mazur. So higher interest rates affect people in several ways. There are a number of interest rates that are tied to market rates. Your car loan rates are typically tied to your market rate. Your mortgage rate is typically tied to the 30-year bond rate. Your credit card rate is tied to a short-term interest rate.

All those things would bump up if you see interest rates across the board going up.

Senator Heinrich. Mr. Chair, I have only got a few seconds left, so I am going to yield them back.

Chairman Paulsen. Thank you. I now recognize Vice Chairman Lee for five minutes.

Vice Chairman Lee. Thank you very much. I appreciate each of you being willing to come and talk to us about these issues today.

We measure a lot of things in this town, and appropriately so. We talk a lot about GDP, about GDP growth, and what government might be doing to affect it.

I think it is difficult to talk about our economic situation and our true economic potential, however, without addressing a number of other issues, things that are more difficult sometimes to quantify, things that are a little bit less obvious, things that account for the social and cultural state of American life. And I tend to think that these other less well measured, or at least less frequently measured and discussed topics, are as important for economic growth and for the health of our economy and our country as anything else.

So I have got a question for all of you. We will start with Mr. Holtz-Eakin and move our way across the table. In measuring our country's long-term viability, how important is the flourishing of America's associational life, or the social capital that is the strength of families, the strength of communities, community cohesion, trust, and collective efficacy? What can you tell me about that?

Dr. Holtz-Eakin. I think it is incredibly important. We know from the data that there is a best practice in America, which is that a young person should go to school, graduate, get a job, get married, and then have children. And if one does it in any other order, it is a ticket one way to poverty. And so those things are at the foundation of economic success in the United States.

We know also from the data, many studies done by a group led by a Harvard University professor, that mobility in the United States, broadly measured, has not changed much in the past 50 years—social mobility, economic mobility. You might think it is not high enough, or you might think it is fine, but it has not changed much. But the geography of it has.

There are places in the United States where mobility has diminished, and diminished sharply. There are places associated with less of those kinds of capital. So I think it is something that is very important although, as you say, very hard to measure.

Dr. Moutray. So last night I was at the STEP Awards, the Science, Technology, Engineering and Production Awards, that honors the 130 women in manufacturing. And you get really a first-hand view of just how important manufacturing is to the lives of these ladies, and to their families, how proud they are of their accomplishments, and just how different it is.

I took my 13-year-old daughter to be able to see just how you can be successful. How, again, manufacturing is that pathway to the middle class. And I think that we need to have more of that emphasis of stressing that women can be successful. Manufacturing can be that engine for growth not just for the economy but for your family and for your community.

And I think that we certainly have done that, and I think certainly timingwise it was good that I was just there last night.

Vice Chairman Lee. Wonderful. Thank you.

Mr. Hampton.

Mr. Hampton. For me, I can just boil it down to personal type stories. A young lady came to us from Chicago who had three children, and she had no job and a husband in prison. And she had little if any education.

We started her out in the assembly area of the company, and she had such a wonderful personality that we brought her into the front office, and my daughter Nicole took her under her wing and started training her how to use email and the like. And now she does all of our order processing, and so forth, and makes in the area of $45,000 per year. And her family is now much more successful. Her husband has gotten out of prison, and the two of them have been reunited, and the program is working very, very good.

But it is social—when you talk about social engineering, I think there is a lot manufacturing and companies can do by looking at people in a whole different way. And that is, what they can contribute as opposed to what they cannot contribute. And we look at it in terms of what capabilities a person has, not what they don't have.

Dr. Mazur. I agree. I think the civic associations and the informal connections are important. It provides for networks. It's social capital that provides informal mentorships.

In addition, businesses also have invested in their communities. And it seems to me, at least today, less so than at times in the past. And that is an area where you can see situations in older industrial communities where there is not that civic engagement, and not that civic capital.

Vice Chairman Lee. Thank you. Thanks to each of you. I am out of time, so I will forego my other questions. I did want to let you know, I released a report today titled "The Geography of Social Capital In America," and it presents a breakdown of social capital statistics broken down at the State and county level. I highly recommend it to each of you and to my fellow Members of the Committee.

Chairman Paulsen. Senator Peters, you are recognized for five minutes.

Senator Peters. Thank you, Mr. Chairman, and each of our panelists. I appreciate your testimony here today, as well.

Dr. Mazur, I was interested when you talked about the jury is out on this tax bill. We have got to see this experiment. Dr. Holtz-Eakin, you mentioned that as well, that this is a pretty grand experiment. We don't know what the results are.

But when I think—and tell me your thoughts—when I think of fiscal policy and how a government should responsibly deal with its spending, it is typically when an economy is strong and when an economy is at full employment or nearly full employment which we are at, normally that is a time when you should start paying down debt, because things can turn the other way.

And as we saw with the Great Recession, it was essential to be able to prime the pump, so to speak, to get the economy going, which was very successful. We have had robust growth and job cre-

ation since what was close to a Great Depression that we were faced with when Martin and I and others, and Eric, I think we all came into Congress about that time.

So just your thoughts. Is this an appropriate time to be going into deep deficit spending, when the economy is recovering? I guess I get the kind of sense that we are kind of on a sugar high right now, and sugar highs are a whole lot of fun but unfortunately they do not last that long.

Dr. Mazur. Yeah, I think President Kennedy once talked about the time to repair the roof is when the sun is shining, right? That is like the good times are when you should be taking those steps in order to shore things up.

And so that is one of the aspects that makes this a big fiscal experiment; that this is a set of policies that is different than what the United States has typically undertaken. Typically we have done stimulus activities during times of economic downturn. Here we are doing a very stimulative fiscal bill during a generally pretty good economic time.

Senator Peters. Dr. Holtz-Eakin, do you agree with that?

Dr. Holtz-Eakin. In part. I think it is important to remember that the baseline budget outlook when President Trump took office had $10 trillion of deficits in it over the next 10 years. So we were going to do deficit spending, regardless.

The Tax Cuts and Jobs Act added to the deficit, no question about that.

Senator Peters. So we have expanded the bill. Was that a good idea, just to put the pedal to the metal and keep going?

Dr. Holtz-Eakin. The core things that I talked about in the Tax Cuts and Jobs Act are not stimulus. They are permanent, structural changes to the tax code to permanently alter the incentives for our businesses in terms of both the location and the scale of their innovation and investment. I think that was crucial.

Senator Peters. Well, we——

Dr. Holtz-Eakin. We were losing companies at a remarkable rate. We had run the experiment about whether the existing tax code was working, and it wasn't. So it had to change. Had I had my druthers—I didn't mean to interrupt—but it would have been revenue neutral. But no one gets everything they want in tax reform, and I didn't, either.

Senator Peters. And I think that is the important thing about revenue neutral. When you say these are long-term structural changes, but they are putting us on a long-term structural deficit, is——

Dr. Holtz-Eakin. We were already on one, is what I would emphasize.

Senator Peters. I wouldn't disagree, but now we have increased it. So if you didn't like the other deficit, you certainly can't like a bigger deficit? Is that true?

Dr. Holtz-Eakin. I don't like either one. I don't like any of them.

Senator Peters. Right. Exactly. So that is what the course we are on that is now increasing that, which is a pretty dangerous course. You know, we do need to have some responsibility here. And I know the short-term impact, as good of a sugar high that

we're on right now, but even the jury is out on that. We are not sure exactly what is going to happen with that.

You have talked about the changes in the entitlements, and I appreciated your response to Senator Heinrich, but, you know, specifically—because you mentioned Social Security. What would you do for Social Security?

Dr. Holtz-Eakin. Personally?

Senator Peters. Yes.

Dr. Holtz-Eakin. I think a combination of raise the minimum benefit, raise the benefit for the most elderly because that is a place of risk right now. Change the indexing in retirement to match the changed CPI. Change the initial awards of Social Security benefits so they are less generous for life-time affluent people, people like me. And index the cap to be 90 percent of the wage base. That is roughly what every bipartisan commission has suggested. I would take the last five conditions, toss them in a hat, pull one out and do it.

What I would emphasize is, doing something. To have that program right now creating cash flow deficits and promising to disrupt retirement lives in 13 years is I think disgraceful. And it is at the core of our social safety net, and it is not the only one. There are many others, as well.

So if you go down the list, each of our social insurance programs, the ones that are supposed to make people's lives safer, are making their lives more dangerous.

Senator Peters. But if I may ask your response, too, on Social Security, part of what happened—and I think of the last major change in Social Security reform was back when President Reagan was here, and there were fixed to the system that everybody said this would last forever, as far as you could see we're going to put Social Security on a sustainable course.

And if I recall—and you can correct me on some of these numbers, roughly about ninety——

Dr. Holtz-Eakin. I don't think that is quite right, but——

Senator Peters. Well as far as I could see at that time, and maybe Ronald Reagan——

[Simultaneous comments.]

But it was for a long time. But what we were doing is basically it was being funded by roughly I think it was in the 90 percent range of the amount of revenue coming into the economy. But what we have seen since that time is growing income inequality in this country in a dramatic way, and now that has shrunk considerably because we have more and more of the income at the very high levels. Their contribution to social security is capped, and middle income folks have actually seen stagnant wages over those years.

So this is a longer term structural problem really I think linked to growing income inequality. I know we don't have time for that answer, but I would love to have that discussion.

Chairman Paulsen. Representative Handel, you are recognized for five minutes.

Representative Handel. Thank you, Mr. Chairman, and thank you to each of you for being here.

Staying along the lines of our social safety net, it is very, very clear that as a country we are extraordinarily compassionate and

generous in that arena. And we are helping millions of struggling Americans.

However, as each of you—several of your have referenced, we really are struggling in terms of the structure of some of these programs in terms of the spending. But also, although well intended, they seem to have in some cases created inadvertently a disincentive to return to the workplace. And then that exacerbates the workforce issues that we have.

What suggestions—and I will start with Dr. Holtz-Eakin—would you have around how can we move more people from being on these social safety net programs and out of the workplace back into the workplace so that we give back that dignity of work and improve the standard of living?

Dr. Holtz-Eakin. That is an enormously complicated question but, you know, I think it is important to just take a look at the entire social safety net and try to make it more pro-work. And to recognize that in many cases the phase-out of benefits, which is intended to be fiscally responsible and things, provides work disincentives for many low-income individuals.

So that those have been some well-documented problems there.

Representative Handel. So dealing with that so-called cliff at the top?

Dr. Holtz-Eakin. Yes, you know there are some program-by-program structural issues, but I think the notion that we should expect people who can work to work is a simple and straightforward one that ought to be embedded all through what we do.

Representative Handel. What are your thoughts on some minimum work requirements for some of these programs?

Dr. Holtz-Eakin. For those who are——

Representative Handel [continuing]. Able-bodied.

Dr. Holtz-Eakin [continuing]. Able-bodied and capable, I think that is an entirely sensible thing.

Representative Handel. Okay. Thank you.

Dr. Moutray, I wanted to talk about a little bit on the regulatory front. What are you seeing in terms of specific regulatory hurdles and the impacts within the manufacturing sector?

I hear a lot from companies in my district, just about one company, 100 employees, 8 of whom are specifically 100 percent dedicated to regulatory compliance. What more can we do as Congress and across the regulatory agencies to start to draw that down?

Dr. Moutray. So thank you. We listened early on at the beginning of the Trump Administration. We asked all of our member companies, all of our manufacturers to submit their ideas for—again, we're in a different environment when it comes to the regulatory space. Keeping in mind that we all recognize we want clean air, clean water, et cetera, but what would you improve if we were to get rid of old regulations? What would you streamline? What are the real burdens that are out there?

We prepared some actual written examples of that and gave it to the Commerce Department at the beginning of last year. So I would start there as examples of places where we could——

Representative Handel. I will give you a card afterwards. I would love to have a copy of that. I am the new kid on the block here, so——

Dr. Moutray. I will definitely get that to you. But I think the bottom line is, we recognize that cumulative burdens continue to get larger and larger.

Last year was a unique year in that there was essentially a moratorium on regulation. But we also want to make sure that, as I said earlier, businesses and manufacturers, especially small manufacturers, voices are being heard.

Representative Handel. Great. Thank you so much. Mr. Chairman, I yield back.

Chairman Paulsen. Thank you. Representative Delaney, you are recognized for five minutes.

Representative Delaney. Thank you, Mr. Chairman.

I want to start by just congratulating Mr. Hampton on the success and growth of your business, and I would also add you are a very effective witness here. So I don't know if you did this in your prior life, but you are very good at this.

But seriously, congratulations on the business.

Dr. Holtz-Eakin, just a couple of questions for you. One of the things that I have been frustrated with is the debate around the deficit where some people say deficits don't matter, and other people say that we shouldn't spend more than we take in.

It has always seemed to me that if we could target deficits at say minus two percent, which is something that is potentially doable even though that is incredibly hard to do, that that would be a more realistic goal, and that would actually be the kind of sensible goal we should have in terms of the long-term fiscal health of the country, because if the economy can grow more than 2 percent a year, our debt as a percentage of our economy will stabilize, which is really the only metric that matters as it relates to these things.

So I am interested in your views on that.

Dr. Holtz-Eakin. I think I roughly concur. I am a little more aggressive. I would like to have the debt as a share of the economy go down a negative downward trajectory. It doesn't have to be sharp, but put us in a position where we're sending the message to world capital markets that we've got our fiscal house in order; that we are not going to end up in a position where we're going to have a sharp disruption of the government, rapid hikes in either interest rates or taxes to deal with things. And that is what you need to do, is to send that clear message to capital markets, and the economic threat of the fiscal outlook would diminish rapidly.

Representative Delaney. So how do you feel about balanced budget acts?

Dr. Holtz-Eakin. Balanced budget amendments through the Constitution are of the class of things called "fiscal rules." And around the globe, there have been countries that have resorted to fiscal rules when they're elected representatives who were unable to get the job done.

Representative Delaney. Right.

Dr. Holtz-Eakin. So they are a recognition of failure. They tend to work.

Representative Delaney. But do you think zero deficits is the right target? Because that is really what it does.

Dr. Holtz-Eakin. Zero deficits? Realistically?

Representative Delaney. Like if you could set economic policy, would you set minus one-and-a-half, which is sounds like you are saying, or would you set zero?

Dr. Holtz-Eakin. I wouldn't set for zero. But I've now been in this town and watched this operation for quite some time. No one has threatened me with zero, or even close.

Representative Delaney. But that is what that law would do.

Dr. Holtz-Eakin. And that is why people are looking to things like the Balanced Budget Amendment. I think they are basically an admission that we are on track for the next ten years——

Representative Delaney. No, I get that. So do you think zero across time would be bad economic policy? Like zero every year?

Dr. Holtz-Eakin. No——

Representative Delaney. No?

Dr. Holtz-Eakin. I think if you look at those Balanced Budget Amendments, the ones that have been considered recently, they have correct-out clauses for major recession, war, circumstances where it would be sensible to run deficits.

Representative Delaney. So do you think the Tax Bill, recognizing that fixing the international system was something that desperately had to be done, so we are in agreement on that, but do you think the Tax Bill would have been a better tax bill if, rather than cutting the corporate rate to 21 we would have cut it to 25 or 26 or 27, and used the additional revenues for something like infrastructure, or to make the bill more deficit appropriate?

Dr. Holtz-Eakin. So I am going to dodge the question at the outset, and then I will answer it. But I will say this——

Representative Delaney. Dodge quickly so we can get to the answer.

Dr. Holtz-Eakin. Okay, as a general matter you never get to choose between the tax reform and the tax reform with the provision you would like.

Representative Delaney. I get all that, yeah. I'm just asking you if you actually could do this.

Dr. Holtz-Eakin. I think getting it to 20 was the right target.

Representative Delaney. You do.

Dr. Holtz-Eakin. We've got to be internationally competitive. Other countries are going to move. It's not like they're going to stay.

Representative Delaney. How do you think a carbon tax could fit in across time?

Dr. Holtz-Eakin. A carbon tax as a consumption tax? I'm a big fan of consumption taxes. As part of a thoughtful strategy for tax policy, you could certainly think about that. As an add-on for the sake of doing it, I'm not a big fan.

Representative Delaney. What do you mean? Explain your answer there more. On what context would you do it?

Dr. Holtz-Eakin. So, for example, the House Task Force came up with what was really a destination-based cash flow tax, it was a consumption of style tax.

Representative Delaney. Right. So you wouldn't do carbon tax on its own?

Dr. Holtz-Eakin. So you could do that in the context of something like that.

Representative Delaney. But you don't think carbon tax on its own?

Dr. Holtz-Eakin. No, not just as a pure revenue approach. I think if we're going to do something as major as that, fix the code you have.

Representative Delaney. Got it. I yield back. Thank you.

Chairman Paulsen. Thank you. Representative LaHood, you are recognized for five minutes.

Representative LaHood. Thank you, Mr. Chairman. And I want to thank all of the witnesses here today for your valuable testimony.

I want to start off with Dr. Moutray. You mention in your testimony how effective the tax reform bill has been and regulatory relief on the manufacturing sector of our country. We have created well over 200,000 new jobs in manufacturing, which people I don't think thought was possible, and it is positive for a healthy and robust economy.

I want to get your thoughts just in the last month here, the last few weeks, on potential trade war as it relates to steel and aluminum tariffs, and how that collaterally will affect manufacturing jobs.

I just looked at a statistic here that, according to the Federal Reserve of Philadelphia, the futures for capital expenditures over the last two months is down [from February to March], dropped 11 percent.

I'm wondering if you can describe the level of fear that a trade war, what that could do to manufacturing?

Dr. Moutray. Well I think first off, let's say that certainly the President is trying to address some real unfairnesses that are out there in terms of what China has been doing in terms of intellectual property, and in terms of overall trade. And so I think that there is that recognition, just kind of putting that out there.

Manufacturers in general don't like tariffs. The NAM itself was founded as a free-trade organization in 1895. And there is a lot of anxiety out there about what could happen on the tariff side.

We actually have been calling, as you know, for hopefully what all of this trade talk really leads to is some more extended conversations with China. Earlier this week, last week, our president and CO asked for a bilateral trade agreement with China, and hopefully this leads to that.

In the meantime, you're right. Certainly our members are very upbeat, but the trade talk and the tariff talk is certainly an uncertainty that is not helpful.

Representative LaHood. And if we do have a full trade war, do you have concerns that this wipes away some of the gains that we've made in tax reform and regulatory relief?

Dr. Moutray. I think it certainly affects the overall level of optimism, yes.

Representative LaHood. Thank you. And, Dr. Holtz-Eakin, can you comment on the level of fear that you have with a trade war and the potential road we're headed down?

Dr. Holtz-Eakin. I'm very concerned. I was in the White House when President Bush imposed steel tariffs. Those tariffs harmed steel consumers more than they helped steel producers.

They bought us nothing on the international front, and they were ultimately disallowed by the WTO. All cost, no benefit. I think these are the same, and I wouldn't have done them. I would echo what Mr. Moutray said about identifying China, but I am unclear on what the strategy is. What is it that we are asking China to do? At what pace? When will we know when we have had a success?

And to get into this kind of tariff war without a strategy and an end game strikes me as dangerous.

Representative LaHood. Do you have any thoughts on the reasoning for the tariffs as it relates to national security, and whether that holds up with WTO?

Dr. Holtz-Eakin. I see little chance the WTO will uphold those tariffs. The Defense Department itself issued a memo that said steel is not a national security issue. We have enough domestically. Aluminum we can get it from reliable partners. So, you know, when the country that imposed the tariff says we really didn't need them, that is not going to help the case.

Representative LaHood. And in terms of suggestions on how we ought to go about this differently in a precision way in going after the Chinese, what is your recommendation on that?

Dr. Holtz-Eakin. I think the lesson of history is that it is very difficult to win a bilateral showdown with the Chinese. And they have the negotiating advantage—and that is the only thing it is—of not having a democracy, and President Xi can just wait us out.

So I think that strategy is not going to be very successful. I would have preferred a multilateral strategy. You know, get a coalition of countries, agree on pressuring China, and move it that way.

Representative LaHood. Gotcha. Switching subjects, we talked a little bit about debt and what that does to our economy. Obviously no matter how fast the economy grows, if spending continues to outpace growth our economy is only going to get worse.

You have referenced that a little bit, Dr. Holtz-Eakin. In terms of reforms to make to our budget process, appropriations process, and spending processes to reverse this, what suggestions do you have for us?

Dr. Holtz-Eakin. Well the good news on that front, there is a Joint Select Committee that is going to take this issue up, and I applaud Congress for that.

I think there are two problems, and one is the near-term problem and the appropriations process, which has led to lots of threats of government shutdown, and threats on raising the debt limit, both of which I view as dangerous.

The longer term problem is mandatory spending. This country balanced its budget on the whole for centuries, and then we invented mandatory spending and we have not balanced it since.

So dealing with how you do oversight and assessment of mandatory spending so that it does not get out of line with the resources is the key issue.

Representative LaHood. Thank you.

Chairman Paulsen. Thank you. Representative Maloney, you are recognized for five minutes.

Representative Maloney. Thank you. And I thank all of the panelists for your testimony.

And, Mr. Hampton, I was very impressed with your business and your testimony. One of the challenges, though, is that most of the business owners that I am reading about, they are not plowing it back into wages. It's usually a one-time bonus. Maybe they will make it permanent later, but a lot of bonuses but not permanent wages that I've been reading. And many are using this tax bonus as paying out to shareholders, as opposed to plowing it back and growing the business like you are. But I hope more people make the same decisions that you've made.

But I would like to ask Dr. Holtz-Eakin about an op-ed that appeared recently in The Washington Post, and I would like permission to place the op-ed in the record.

Chairman Paulsen. Without objection.

[The Washington Post article appears in the Submissions for the Record on page 76.]

Representative Maloney. It was written by five very prominent former Chairs of the White House Council of Economic Advisers, Jason Furman, Alan Kruger, Laura Tyson, Martin Neil Bailey, and Janet Yellen. The economists argued that in the future the United States will face a large debt crisis, as we've all been talking about, but they argue that entitlements—Social Security, Medicare, and Medicaid—are not to blame. And they make three points that I find interesting, and I would like to hear your response.

Number one, they write that the large tax cuts and unfunded wars have been huge contributors to our current deficit problem, and the primary reason the deficit in coming years will now be higher than it had been expected is the reduction in tax revenue from last year's tax cuts, not an increase in spending.

Do you agree with their assessment? Would you begin with a "yes" or "no" and give your explanation to that first point?

Dr. Holtz-Eakin. I do not agree with them. Again, I would go back to——

Representative Maloney. It's $1.7 trillion, by all accounts.

Dr. Holtz-Eakin. I would go back to the baseline budget outlook of January 2017, prior to any tax legislation, which showed that there would be an additional $10 trillion in deficits over the next ten years, and that did not come from the discretionary accounts. It came from the mandatory accounts. So it wasn't wars. And it came because all of the mandatory spending grows at rates faster than the economy, faster than any plausible revenue gain. Those are the entitlement programs.

So arithmetically, I think they are simply incorrect.

Representative Maloney. Okay, secondly, the five economists further write that the tax cuts passed last year added an amount to America's long-term fiscal challenge that is roughly the same size as the preexisting shortfalls in Social Security and Medicare. Do you agree, "yes" or "no" with that, and your explanation?

Dr. Holtz-Eakin. I disagree, but I think it is a misleading statement by them, quite frankly. They compared it to Medicare Part A, which is a subset of the entire Medicare program. The entire Medicare program is three-quarter financed out of general revenue. Parts B and D were structured that way, and they run enormous cash flow deficits, over $300 billion a year. And to throw them out

of that calculation and compare it only to Part A is to really mischaracterize the situation.

Representative Maloney. Thirdly—and Mr. Peters brought this up, too, and others on the panel—the economists write that decreasing our debt-to-GDP ratio will require running smaller deficits in strong economic periods such as the present to offset the larger deficits that are needed in recessions to restore demand and avoid deeper prices. Do you agree, "yes" or "no"?

Dr. Holtz-Eakin. That is a beautiful theory in textbook. No government, Republican or Democrat, in my lifetime has done it.

Representative Maloney. Okay. And lastly, or is my time up, four years ago the consensus estimate at the Fed of the NARU, the nonaccelerating rate of unemployment, was 5.4 percent. And what likely would have happened if the rate dropped further, as it has, and in response the Fed has raised interest rates, which they are saying they are going to do?

Dr. Holtz-Eakin. I think it is a good news story if the Fed is worried about the economy growing too fast. That has been the least of our concerns for a long time. It celebrates what they admitted were unusually low, and were labeled extraordinary monetary policy because they became very ordinary as we got used to them, so I think it's a good news thing that they are normalizing the stance on monetary policy.

I think it has been surprising the degree to which the employment rate has been able to fall, and we've seen labor participation rise more than I think a lot of people expected. We see no particular evidence of current inflation as a result of this, and we do see some acceleration in average hourly earnings. That is all a good news story, and I hope it continues.

Representative Maloney. My time has expired. Thank you.

Chairman Paulsen. Thank you. Representative Beyer, you are recognized for five minutes.

Representative Beyer. Thank you, Mr. Chairman, very much.

Dr. Mazur, tomorrow we have the House taking a doomed-to-fail messaging vote on the Balanced Budget Amendment, probably to provide cover for Members who are feeling buyer's remorse after their deficit-increasing votes, and faced with the new CBO deficit figures.

But now, as it seems like we have built a house of cards with more than trillion-dollar deficits for the foreseeable future, how do we possibly consider long-term sustainable growth? How are we unlocking America's economic prospects when our debt levels will quickly equal GDP, with ever increasing pressure on interest rates? What is the smart way to address the debt and deficit we have?

Dr. Mazur. So I think the point that Douglas Holtz-Eakin and I both made is that in good times you should be running smaller deficits, to kind of be on a downward trajectory, so that it becomes—the debt becomes a smaller fraction of your economy over time.

And I think you saw that in the late 1990s, where the budget was actually in balance for the late 1990s, early 2000s. And then we embarked on a series of tax cuts and unpaid-for war, and Medicare benefits expansion, and we moved into a situation where we had larger deficits.

So kind of to harken back to what I mentioned earlier about President Kennedy, that the time to really work on repairing your fiscal situation is when things are going good, during the good economic times. And it seems to me we are having a missed opportunity. We have an opportunity to do it now during relatively good times, and we are not taking advantage of that.

Representative Beyer. I would like to compliment Mr. Hampton on sharing so much of the benefits to his business of the tax cuts with your employees. But as many predicted, we have seen that as opposed to fueling wage increases, or even investment in the recipient businesses, the lion's share of the corporate tax cuts, some say greater than 80 percent, is going to stock buybacks and dividends.

Dr. Mazur, do you see limiting the use of buybacks, which we used to do until regulatory changes in the early 1980s, as a worthwhile public policy response that would promote a natural focus on wages and investment in research and development, rather than all of it going to the people who own the assets that we have?

Dr. Mazur. I view a stock buyback as more of a financial transaction which keeps the value of the company the same. It's just dollars of cash goes out and shares get retired. So the company stays about the same size.

Now there may be concerns about earnings-per-share being driven up because there are fewer shares out there, but that is really the responsibility of the board of directors of the company to look at that, not—I don't really think it is a Federal Government responsibility.

Representative Beyer. Isn't part of the issue, if you look at Dr. Holtz-Eakin—again, Dr. Mazur—where early on he points out that the growing gap between the productivity rate of increase and the wage rate of increase, that—and we have had year after year of record corporate profits, that businesses haven't been sharing the increases in productivity gains with their people?

Dr. Mazur. There may be some truth to that. I think that, you know, we have had a stagnant minimum wage over the last number of years. We have not increased the minimum wage. We have had a reduction in unionization over decades now. Both of those would have been ways to get more dollars into the pockets of the workers, and we have not done either of those things.

Representative Beyer. Finally, Dr. Mazur, we have seen that the pass-through provision seems to fail to meet all four of the standards of good tax policy that you laid out in your testimony.

We are already seeing in The Wall Street Journal that this sets the bill so that the most tortured gaming has occurred since the passage of the new tax law. The tax law Professor Dan Shaviro called it, quote, "the worst provision ever even to be seriously proposed in the history of the Federal income tax."

Is there any way to fix this?

Dr. Mazur. That is a hard question. I think that you are setting up a situation where it is relatively easy, through paper transactions, to change the form of income from one level of tax to a different, to a lower level of tax. And you would expect to see gaming on that front.

One of my law friends also quipped, similar to Dan Shaviro, that the jobs part of the Tax Cuts and Jobs Act was the tax planners' jobs. That there will be many tax planner jobs as a result of this, and that is an example in the flow-through area where you could see that be the case.

Representative Beyer. Thank you very much. Mr. Chair, I yield back.

Chairman Paulsen. Thank you. And I was going to say we are going to start with a Minnesotan and end with a Minnesotan, but Senator Cruz just got here, but we will go with Senator Klobuchar and you are recognized for five minutes.

Senator Klobuchar. Well very good. I had my moment a few years ago, speaking of unleashing the economy, where Minnesota beat out Texas as the best State to do business in in the CNBC survey. And I completely enjoyed telling Senator Cruz about it.

But I do welcome Mr. Hampton. He is a real success story right out of Rogers, Minnesota, which is on the western part of the metropolitan area, and I grew up not far from there, employing 22 Minnesotans and Americans. I thank you for that.

And I note that your business is—Senator Heinrich and I were thinking that you are in the business of circuit interruption technology and that we need a little circuit interruption around Washington right now, so maybe you can bring us some.

So thank you for that. I thought I would start with you, Dr. Holtz-Eakin, and talk to you about—I was just around our State in a lot of the rural areas last week, and there is just a huge problem with workforce shortages everywhere. I heard it from medium-sized companies manufacturing to peat mines, to the just regular farming.

And we have done a lot of work with apprenticeships, and I think we should be doing more nationally. Senator Collins and I have a bill on this, and maybe loosening up some of the rules about how old kids are when they can start doing apprenticeships while they are in school, because it is a patchwork of State and Federal laws. And I am going to talk to the Labor Secretary about that. Doing more on STEM, obviously. And just some very cool things going on with our high schools around Minnesota where kids in 9th grade are getting exposed to a class with tech, or the traditional shop, which it no longer is, robotics. And then having kids choose a traditional track, or health care, or manufacturing.

And those are all good things and are incredibly important. I still don't think it is going to fill the short-term need that I am seeing in our State.

So I just wondered if you would comment about immigration reform. And right now we are going backwards. I had a turkey producer who, the new rule is he can't get his part-time seasonal workers, he can't get them from the same country anymore. He has to rotate countries, and he had the same crew coming in for 17 years, and we just are seeing with the Dreamers not getting on a path to citizenship. Liberians in our State, we have the biggest population, they only have a year left who are on the Temporary Status. They all came in legally.

And I just see this as sort of coming right up against our potential for unleashing our economy because we are going to start hav-

ing workforce shortages. And there are two ways to do this: training the kids who are growing up, and retraining some workers; and then of course immigration reform.

And could you comment on those two things?

Dr. Holtz-Eakin. Well first of all, congratulations on the apprenticeship work. I am a big fan of those sorts of efforts. I would like to know more about it.

I remind everyone who asks me about the immigration issue that the native-born U.S. population has fertility low enough that in the absence of immigration the United States shrinks. We become Japan. We become smaller in population, smaller in economic size, smaller in our ability to protect our values and spread them around the globe.

And so the flip side to that is that immigration reforms and policies are a huge economic opportunity, and one that I think we should pursue vigorously.

I am not a big fan of what I see going on right now. I think we are going in the wrong direction, and we ought to think hard about legislation that would in fact put this more on an economic foundation both in terms of the long-term visa-granting, but also in terms of the need for seasonal workers and sensible temporary worker programs that have a real effort at enforcement.

Senator Klobuchar. Well and as you know in the comprehensive bill that passed the Senate with strong bipartisan support we actually had worked out the ag issue with migrant groups, and the Farm Bureau, and the Farmers Union, and that was something that was in there which we would love to see today.

And I just look at it. I like that we had—I did a hearing here once on immigration reform, and we actually had Grover Norquist testify in favor of immigration reform because he saw it as reducing the debt, because you have more people paying in by billions of dollars. So I just think it is a really important point to make as we go through.

I don't know if anyone else wants to comment on any of that?

Dr. Holtz-Eakin. It is just one of those issues that unites bearded right-wing crazies, and we thank you.

[Laughter.]

Senator Klobuchar. Dr. Moutray.

Dr. Moutray. Well we have The Manufacturing Institute at the NAM, as you know, Senator, which has really been specializing in trying to address that skill shortage. And as I noted earlier, it is our number one issue, and we go out and ask our members. As I travel around the country, I hear it everywhere, small, medium, and large, in every State.

And so we have been trying to do a number of things, including encouraging more women, as well as trying to change perceptions.

Senator Klobuchar. Any others? Mr. Hampton, do you want to get the last word maybe, our Minnesotan?

Mr. Hampton. We have found opportunities to employ people from all walks of life, by just keeping our eyes open. And that may mean the local waitress who is showing something going to school, and we give her an opportunity. As a matter of fact, that is a case-in-point. Recently we did hire somebody like that, and are bringing

her along in an office environment where she wasn't going to get an opportunity because she was a 40-year-old waitress.

And just by going that direction and paying her a little more money, we now have an excellent employee.

Senator Klobuchar. Good point. Thank you.

Chairman Paulsen. Thank you. Senator Cruz, you are recognized for five minutes.

Senator Cruz. Thank you, Mr. Chairman. And I would note to the Senator from Minnesota, talking about Texas and Minnesota rivalries, that it appears likely now, or at least a good chance, that starting this weekend the Houston Rockets will be facing the Minnesota Timber Wolves in the NBA playoffs.

Senator Klobuchar. We hope that is true, yes.

Senator Cruz. You all are—but perhaps we may have a side wager on the outcome——

Senator Klobuchar. Alright, okay.

Senator Cruz. Good afternoon, gentlemen. Welcome. Thank you for being here.

As you guys know, on the tax reform bill, because it was passed on Reconciliation, some elements of it are scheduled to expire. Notably, the individual tax cuts and the expensing provisions.

In your judgment, what impact does the expiration of those tax cuts have on likely future economic growth? And how would those projections be different if those elements of the tax cut were permanent instead?

Dr. Holtz-Eakin. I think you see those impacts in the CBO analysis where there are strong near-term impacts, and they diminish over the 10-year window. Permanent tax policy is always more powerful and better than temporary tax policy. And that, had it been possible, would have been a preferable route to go.

Dr. Moutray. I agree with that. Certainly I think when you look at, from a manufacturing standpoint, the expensing provision is what really allows so much of the growth that we are seeing in this year and kind of moving forward. But we would like to have seen those made permanent. We hope that they are made permanent at some point.

Mr. Hampton. A typical approach would be for a company like ours, which is privately owned, for the proprietors to increase their own wages in order to offset the increase in taxation.

So if we want to maintain the benefit of the tax cuts to our corporation and retain money in that corporation, which is what we want to do, then the way to achieve it is certainly not to increase the personal tax.

Dr. Mazur. Senator Cruz, I think making the investment and incentives permanent would make them more effective. However, it should be paid for. It shouldn't be just run up on the credit card of the Nation.

And I disagree a little bit with your point about Reconciliation requiring that. I think that was basically a statement of priorities, that you had one-and-a-half trillion dollars, and you spend X on corporate stuff, Y on individual stuff, and the Y only lasts for seven years.

Senator Cruz. So if Congress in 2018 were to revisit tax reform and make expensing and make the individual tax cuts permanent,

what would you expect the impact to be in terms of economic growth and jobs going forward?

Dr. Holtz-Eakin. I think in and of itself it would be beneficial. Probably not large in the near-term, but you would get better out-year projections. I think it would be even better if those were paired with reforms to the mandatory spending program so that you didn't increase the deficit. That would be the strongest economic impact.

Dr. Moutray. Manufacturers are very long-term in their thinking. They are looking about investments that are going to be paying out many years down the line. And so I agree with Doug. I think you're going to see, especially in those out-lying years, you are going to see similarly positive impacts from that.

Mr. Hampton. Our programs are, as we look at it presently, we are looking towards a longer term future as a result of the tax cuts for aggressive investment in the company. So if we look down the road and we're saying that there's going to be a reversal of these kind of things, it makes it more problematic for us to set our plans.

Dr. Mazur. And I just think that there are going to be plenty of opportunities for Congress to revisit this tax law, that you have things that expire in 2019, 2022, 2025. There will be plenty of opportunities to take a look at it and look at what our fiscal situation is and make the necessary adjustments.

Senator Cruz. Shifting topics to regulatory reform, if Congress were to pass structural regulatory reform—something like the REINS Act which provides that any economic regulation that imposes over $100 million of cost on the economy can't go into effect without an affirmative up/down vote from Congress—what would each of you expect to be the impact on the economy on economic growth and jobs if the REINS Act were enacted?

Dr. Holtz-Eakin. As I said in my opening remarks, the burden of regulation of over $100 billion a year for eight years I think has an important impact on the economy. And to have a statutory check on that would be an enormous benefit.

I wish we had better sort of empirical estimates from the research literature. We don't. But it is certainly directionally an important thing to do.

Dr. Moutray. The manufacturers certainly are responding to the changed environment, and recognizing that the rulemaking process is different. You know, two out for every one coming in I think is a completely different ball game. And certainly I think they would react very favorably to continued changes in the positive direction for regulation.

Dr. Mazur. I don't know enough about the REINS Act to have a well-formed opinion on that, so I think I will pass.

Senator Cruz. Very good. Thank you, gentlemen.

Chairman Paulsen. Thank you. And with that I want to thank all of our witnesses for taking the time to be with us here today, and remind Members that should they wish to submit questions for the record, the hearing record will remain open for five business days.

And with that, our Committee is adjourned. Thank you.

[Whereupon, at 3:50 p.m., Wednesday, April 11, 2018, the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF HON. ERIK PAULSEN, CHAIRMAN, JOINT ECONOMIC COMMITTEE

I call this hearing to order.

Good afternoon, and welcome to this hearing on "Unleashing America's Economic Potential."

For the eight years prior to this new Administration, we were told America could never do better than 2 percent growth. We were told that such sluggish growth was the new normal, and that we had to lower our expectations.

This contradicted what we knew to be true about America.

We all know America is an economic powerhouse. We are blessed with vast and bountiful land, massive energy resources, and most importantly, the American people. Our dreams, as a nation, don't rely on government fiat or foreign influence, but on the resourcefulness, the innovativeness, and the hard work of everyday Americans.

The question is: Will we, elected officials of the U.S. government, allow them to work towards their dreams and fully contribute to our nation's prosperity?

This hearing is about just that. How is it, for instance, that we have just seen a remarkably good job growth for the last few months?

Listen to these numbers:

We are averaging 214,000 more jobs for February and March and the employment-to-population ratio held steady.

The unemployment rate has remained stable at 4.1% for 6 months, the lowest since 2000.

Meanwhile average hourly earnings continue their upward trend.

It wasn't long ago, we were told not to expect this. In fact, we were told to lower our expectations. I'll explain.

When my daughters set goals, these goals are generally beyond where they are at the time. Maybe they want to get better at math or science. Maybe they want to read more books than before. But the point is, they know their potential, and set goals beyond where they are currently at because they want to grow.

It should be the same when thinking about our economy.

The first graph was displayed at our last hearing. The top line is what the Congressional Budget Office thought in 2007 our economy was capable of producing. This is an economy of hope and growth.

The bottom line, regrettably, is what our economy in fact produced—our actual real GDP. To be sure, the financial crisis knocked us off our feet.

The lines in between are annual CBO forecasts of our economic potential over the course of the Obama Administration. Each year, these forecasts were lowered.

This is what it looks like when a nation is urged by its leaders to accept mediocrity and to let the government handle more. More taxes, more regulations, and more control meant that the American economy was held back.

This was a self-fulfilling prophecy.

These projections dragged under growing weight of high tax rates and record-setting levels of regulation.

Before 2017, economic growth was slow, employers weren't willing to invest in their businesses or their employees.

Productivity and take-home pay stagnated.

People in their prime working years stayed out of the workforce.

Fewer people were willing to risk starting a business so entrepreneurship fell.

Businesses found it more attractive to invest and create jobs overseas, where other countries had learned to lower their corporate tax rates and reduce regulations.

At the same time, the federal government's power over nearly every aspect of our lives grew.

Yes, there are constructive things that government does, such as by keeping us safe, enforcing civil and property rights, and setting rational "rules of the road" by which the economy can operate efficiently.

However, government does not create prosperity.

Our people create prosperity—by having great ideas, working hard, and having the resources to take a risk on building a piece of the American dream.

Far too often government stands in the way of prosperity and opportunity by overtaxing and overregulating.

A country's GDP is based on its workforce, capital stock, and productivity—determined by technology, innovation, and training. It isn't based on how much the government succeeds in redirecting capital.

We're seeing a different course that lifts the artificial restraints government imposed on the economy.

This graph is similar to one in the report the JEC published last week in response to the Economic Report of the President.

If we lift the government constraints of high taxes and heavy regulation that weighed down our potential, our economic potential can rise. If it rises to what CBO projected as recently as 2012, there would be plenty of room, displayed as the output gap, for our economy to grow faster.

We've removed the government obstacles that prevented Americans from achieving their dreams.

When growth is strong, businesses have the confidence to invest, jobs are plentiful, potential entrepreneurs become willing to risk starting a business, and American households become more prosperous. We're already seeing results:

Every quarter of economic growth in 2017 outperformed the same quarter in 2016;

Business investment is strengthening and small business confidence is high;

Production and investment are coming back to the United States;

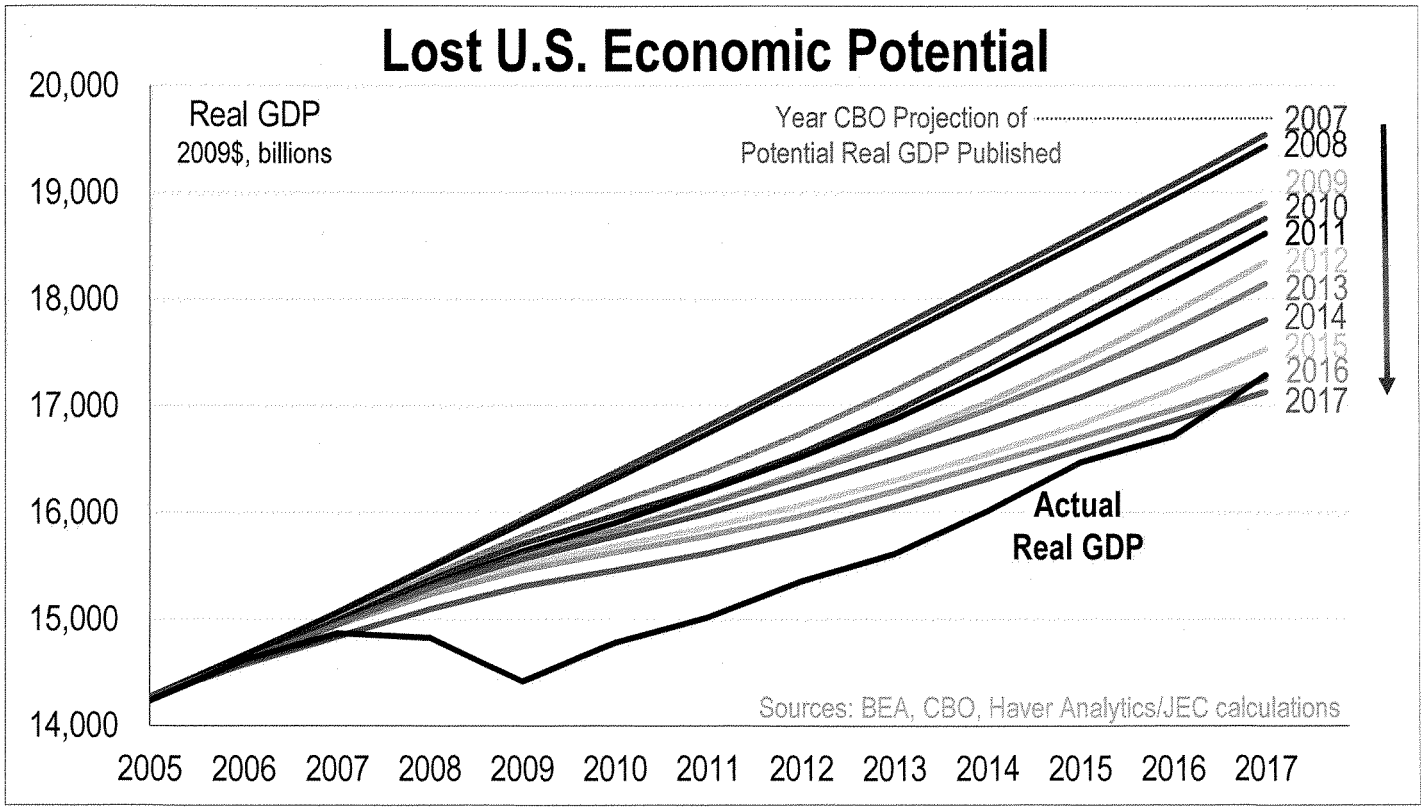
Paychecks are growing because (1) the government is taking a smaller cut and (2) businesses are investing in their workers.

In my home State of Minnesota, the good news about tax reform keeps pouring in as companies like Best Buy, Bio-Techne (BIO–TECH–KNEE), CIT Relay & Switch, LORAM, Data Sales, DTN, Hormel, TCF, and US Bank invest in their employees by giving them special bonuses, pay raises and better benefits.

But even with the tailwinds of pro-growth tax and regulatory reform, there are still risks to the economy, such as the newly announced tariffs. Trade is critical to our economic growth. A robust trade agenda is essential for the United States to grow jobs by selling American goods and services around the world as 96% of world's consumers live outside the United States.

The end goal of trade policy should be to eliminate artificial barriers to the free flow of our goods and services, not cause new ones.

I look forward to hearing from our distinguished panel of witnesses today as they advise us on ways to unleash greater opportunity in America.


Lost U.S. Economic Potential
Real GDP
2009$, billions
Year CBO Projection of
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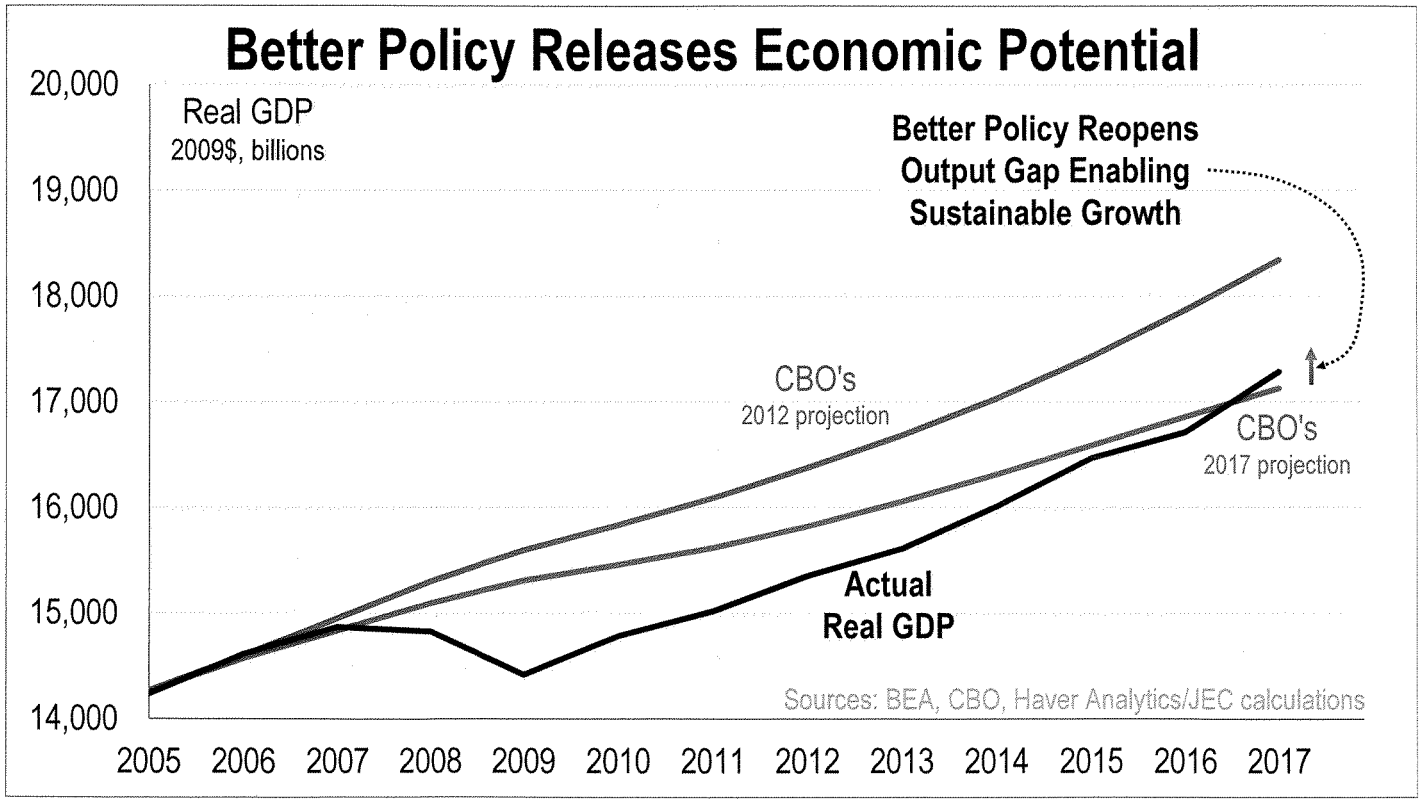
Better Policy Releases Economic Potential
Real GDP
2009$, billions
20,000
19,000
18,000
17,000
16,000
15,000
14,000
Better Policy Reopens
Output Gap Enabling
Sustainable Growth
CBO's
2012 projection
CBO's
2017 projection
Actual
Real GDP
Sources: BEA, CBO, Haver Analytics/JEC calculations
2005
2006
2007
2008
2009
2010
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2012
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2014
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2017

PREPARED STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, JOINT ECONOMIC COMMITTEE

Thank you for calling today's hearing on promoting innovation and accelerating economic growth.

Innovation drives economic growth and boosts wages. We need more of it and we need innovation to be more broadly shared across regions.

Other countries are moving forward aggressively to promote innovation, to support advanced manufacturing, and to boost the productivity of their workers.

To lead in the 21st century economy, the United States must remain at the forefront of game-changing discoveries and create an ecosystem that supports innovation across the economy.

The Federal Government plays a key role in this—funding and conducting R&D, investing in the human capital of our people, and ensuring that we are making the necessary investments in STEM.

STEM education and R&D are two innovation anchors.

We need to ensure that students everywhere have access to STEM pathways, and that starts with making sure that schools have the resources they need to recruit, train, and retain talented science and math teachers.

We need to expand middle-skills pathways into emerging sectors, and make a college education accessible and affordable for all Americans, so that every student has the opportunity to benefit from tomorrow's innovations.

The Federal Government remains the largest funder of basic research—that research which adds to our fundamental stock of knowledge, yet often would not be conducted without public investment.

This is the research that can help us solve the problems we don't yet know we have.

Basic research has driven major leaps forward—including mapping of the human genome, vaccines, breakthroughs in cancer research, and energy storage technology and the creation of the internet, laser, MRI and GPS.

The knowledge gained through this research has significant spillover economic benefits—increasing productivity, creating jobs, and accelerating economic growth.

That's why it's encouraging that the recent Omnibus agreement made significant investments in R&D.

Investments in basic research increased by almost 10 percent over the previous year, its largest annual increase since the Recovery Act in 2009.

Promoting innovation also means extending already developed technologies, like broadband, to communities currently without access.

Today, years after high-speed internet was first made available, 19 million rural Americans still lack access. The private sector doesn't have the incentive to extend broadband to remote, hard-to-reach communities.

The Federal Government must step in and fill the gap.

We also need smart policies that can help emerging industries grow. Targeted tax credits, competitive grants, and prize competitions are all levers Congress can pull.

The multi-year extension of the wind production tax credit is a good example. It is driving investment in wind farms in New Mexico and across the country.

Earlier this month, I toured the future site of the $1.6 billion Sagamore Wind Project in eastern New Mexico, which will be the largest wind farm in our State's history and create up to 300 construction jobs and 30 full-time operations jobs.

Programs like Laboratory Directed Research and Development (LDRD) authorizing a portion of a lab's Federal funding for cutting-edge R&D are also vital.

At Los Alamos National Laboratory in New Mexico, LDRD researchers generally account for one-quarter of the lab's patents and peer-reviewed publications.

Efforts to help commercialize technology developed at our national labs and research universities help to take a good idea and get it into production and out into the market place.

In New Mexico, we've seen how commercializing the R&D that takes place in national labs can generate significant economic opportunities.

I'll share one example.

Descartes Labs is a New Mexico start up that uses artificial intelligence technology developed at Los Alamos National Laboratory to provide analysis and predictions based on satellite images of the earth.

Early applications are in delivering crop yield forecasts and analyzing trends in energy, construction and the environment.

Today, the company has its headquarters in Santa Fe, has raised close to $40 million in venture money, employs about 70 people, and is a recognized leader in analyzing satellite images.

We need to help more research turn into innovative startups.

Access to capital is key for entrepreneurs. Too many promising young companies fall to the Valley of Death, or get absorbed by behemoths where their innovations stall, because they cannot find the financing they need.

This is especially tough for innovators in rural areas and smaller cities. Good ideas and innovations occur everywhere. But more than three-quarters of venture capital go to companies in San Francisco, Los Angeles, New York and Boston.

Expanding access to capital can help us to tap into the next generation of innovators creating new startups and new opportunities.

Lastly, immigrants are a key source of innovation and entrepreneurship. We cannot jeopardize these enormous contributions through short-sighted immigration policies or by kicking out talented young people.

I'm an engineer by training. I could talk all day about innovation, R&D and tech transfer.

But, now I look forward to hearing from our witnesses.

Unleashing America's Economic Potential

Testimony to the Joint Economic Committee

Douglas Holtz-Eakin, President
American Action Forum*

April 11, 2018

*The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I thank Gordon Gray for his assistance.

Introduction

Chairman Paulsen, Ranking Member Heinrich and members of the Committee: I am honored to have the opportunity to testify on the necessity of a pro-growth policy agenda. Pro-growth policies are essential for ensuring that current and future American families enjoy the same—or greater—improvements in their living standards as previous generations.

In my testimony, I wish to make three simple points:

- Encouraging more rapid long run economic growth remains the most pressing policy issue faced by the Congress;
- The Trump Administration has pursued a policy agenda that has had a mixed effect on the economic outlook – with tax reform and regulatory policy achievements contributing positively to the growth outlook, but immigration and trade policies introducing needless economic headwinds; and
- Notwithstanding the policy developments of the past year, considerable work remains to improve the economic trajectory of the United States.

Let me discuss these in turn.

Recent Economic Performance and the Growth Challenge

Supporting more rapid trend economic growth is the preeminent policy challenge. 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 give the next generation a less secure and less prosperous nation.

Figure 1: Disappointing Economic Growth

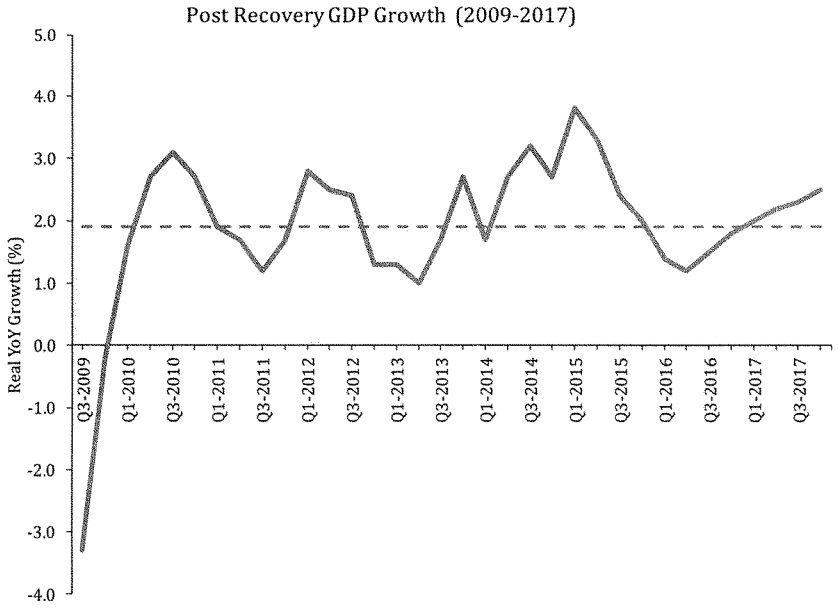
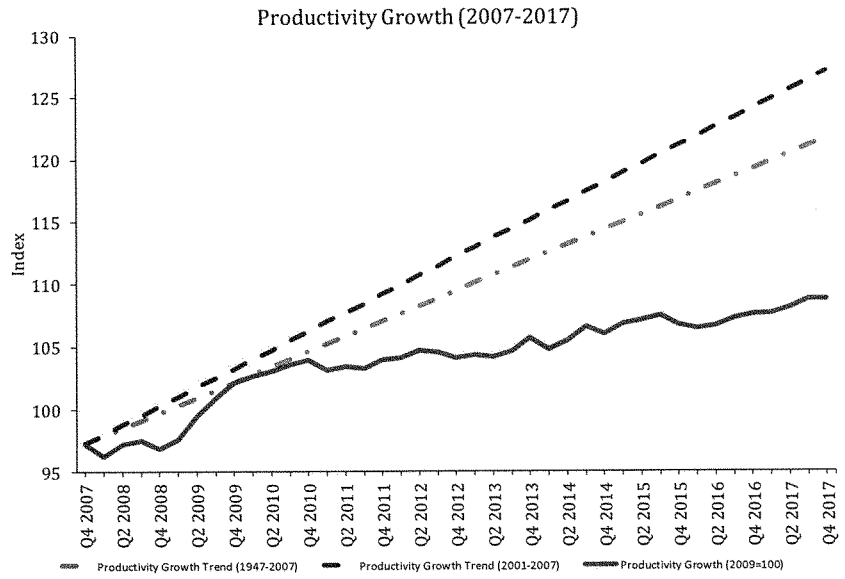


Figure 1 shows quarterly, year-over-year growth rates for real gross domestic product (GDP) since the official end of the Great Recession in June of 2009. As displayed, real GDP growth has been stubbornly weak, averaging 1.9 percent (the dotted line). While recoveries from recessions precipitated by financial crises tend to be weaker, the persistence of the nation's weak economy should not be considered inevitable, but rather as an encouragement to implement better economic policy.

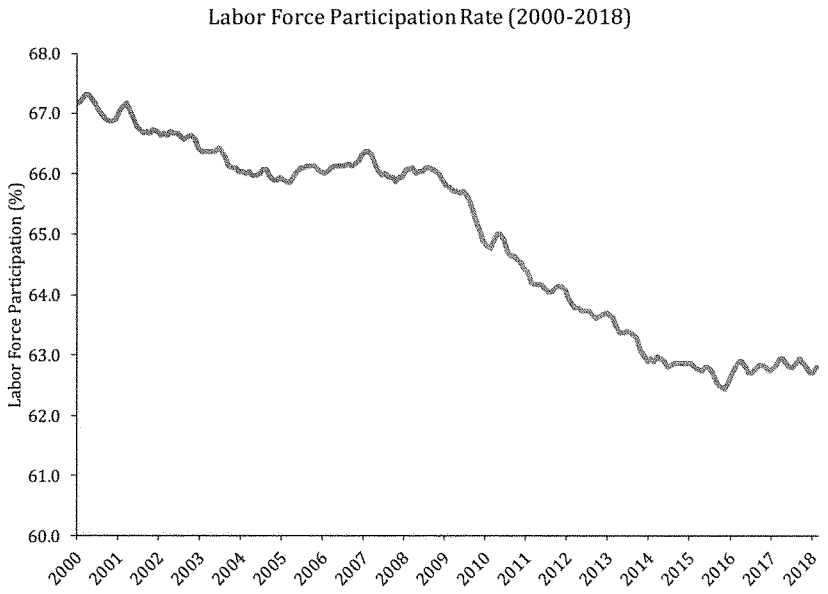
Figure 2: Productivity Growth is Lagging Past Performance



Source: BLS

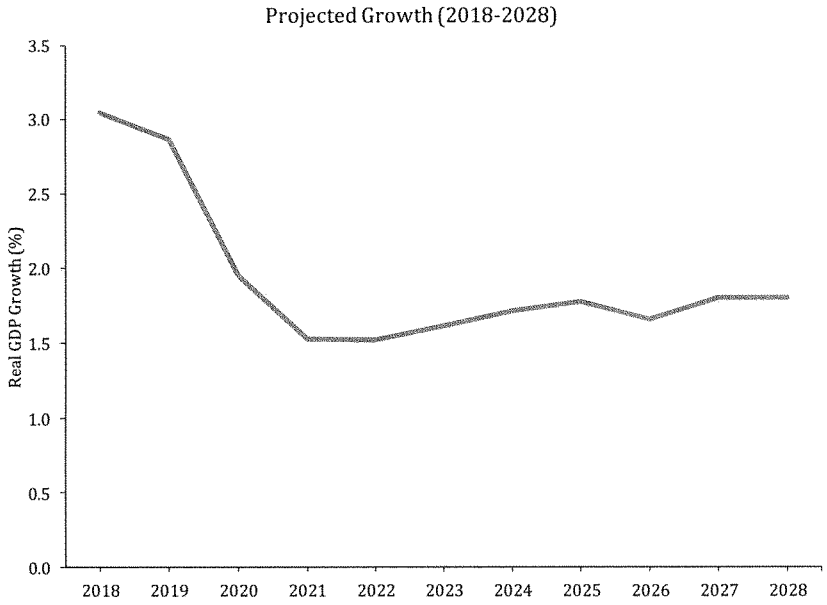
Household income, a metric that more working Americans can appreciate, underscores the tepid economic recovery. According to the most recent comprehensive income survey conducted by the U.S. Census Bureau, earnings growth of men and women who worked full-time and year-round was essentially zero in 2016.[1] Stagnant earnings growth reflects poor productivity growth that lags behind the rate seen in other recoveries or the prevailing historical trends (see Figure 2).[2]

Figure 3: Labor Force Participation



The other essential building block for stronger trend economic growth is growth in the labor force – the population willing and able to work. As a share of the population, the labor force has declined from historical highs in 2000, but this decline has accelerated since the Great Recession (Figure 3).

Figure 4: CBO April 2018 Baseline



Even more troubling than the recent economic past is the outlook. The Congressional Budget Office (CBO) projected in its April *Budget and Economic Outlook* that U.S. economic growth will average 1.9 percent over the period 2018-2028. This is essentially unchanged on average from CBO's June projections, but reflects near-term improvement largely attributable to the Tax Cuts and Jobs Act (TCJA) that dissipate over the budget window.

The rate of growth projected in the current economic baseline is certainly 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 25 years, however, these rates 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 rates were 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 is subject to outside influences – including public policy.

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

Trend Growth Rate Per Capita (%)	Years for Income to Double
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 1.9 percent. When combined with population growth of 0.8 percent, this implies the trend growth in GDP per capita will average about 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.

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

A Policy Regime for Faster Trend Growth – Assessing Recent Developments

Given the poor growth legacy of the last administration, Congress and the current administration must break from the economic policies of the past decade.. "Economic growth policy" is more a philosophy than a piece of legislation. It is a commitment at every juncture in the policy process to evaluate tradeoffs between social goals, environmental goals, special interest goals, and economic growth – and then to err on the side of growth.

The second flaw in the prior administration's policy approach was its misguided reliance on temporary, targeted piecemeal policymaking. Even if one believed that countercyclical fiscal policy ("stimulus") could be executed precisely and had multiplier effects, it is time to learn from experience that this strategy is not working. The various stimulus programs – the Economic Stimulus Act of

2008(checks to households), the American Recovery and Reinvestment Act (the gargantuan stimulus bill in 2009), the Car Allowance Rebate System ("cash for clunkers"), the Federal Housing Tax Credit (tax credits for homebuyers), the HIRE Act (consisting of a $13 billion payroll hiring credit, expensing of certain investments, $4.6 billion for schools and energy), the Small Business Jobs Act of 2010, and the state-local bailout Public Law 111-226 ($10 billion to education; $16 billion to Medicaid) – all have failed to generate adequate growth.

Just as the policy regime of macroeconomic fiscal (and monetary) fine-tuning backfired in the 1960s and 1970s, leaving behind high inflation and chronically elevated unemployment, this regime has worked no better in the 21st century. The Trump Administration and the Congress have an opportunity to commit to raising the long-term growth rate of the economy through permanent reforms. We have seen some noteworthy progress toward this goal, specifically with respect to tax reform and regulatory policy. But the administration has also pursued trade and immigration policies that are decidedly anti-growth, risking the progress made in other areas of economic policy. This Committee can and should continue to serve as a forum for encouraging sound economic policies that support a pro-growth agenda and dissuading those policies that impede such an agenda.

Tax Reform

Prior to the enactment of the TCJA, the U.S. tax code was broadly viewed as broken and in need of repair, and for good reason. Whereas the previous administration and past Congresses made the tax system worse – adding higher rates and new taxes, including on the middle class – the Trump Administration and Congress embarked on an effort to overhaul the fundamentals of the nation's tax system. A sound reform of the U.S. tax code was an essential element of a pro-growth strategy, and this reform promises to support substantially increased long run economic growth.[3]

The last time the United States undertook a fundamental tax reform was with the Tax Reform Act of 1986 (TRA). A robust literature demonstrates negative relationships between higher marginal rates and taxable income, hours worked, and overall economic growth.[4] 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 9.4 percent because of tax reform.[5] 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 4.4 percent over 10 years – a growth effect that roughly translates into about 0.4 percent higher trend growth, resulting in faster employment and income growth. This theoretical work essentially staked out the upper bound for the growth potential from tax reform.

The TCJA addressed some of the most glaring flaws in the business tax code:It lowered the corporation income tax rate to a more globally competitive 21 percent, enhanced incentives to investment in equipment, addressed some of the disparate tax treatment between debt and equity, and refashioned the nation's international tax regime. Primarily for these reasons, the TCJA will enhance the nation's growth prospects. The likely growth effects over the long-term will fall short of the theoretical ideal but will ultimately be positive. The long-run contribution to GDP from the TCJA could be as much as 3 percent, though there are a range of credible estimates and myriad factors that could alter the ultimate impact of the TCJA on the economy.[6]

The TCJA is not an ideal tax reform, however, and there remains considerable opportunity for improving the law itself and the overall tax environment in the United States

Regulatory Reform

Perhaps the most striking policy departure from the previous administration has been in the area of regulatory reform. The Obama Administration finalized a costly regulation at the average rate of 1.1 per day, and the cost of complying with those regulations cumulated to $890 billion – according to the agencies themselves that issued the regulations. That cost is an average stealth tax increase of over $110 billion a year. Enter the Trump Administration, which from the president's inauguration to September 30 of last year (the end of the federal government's fiscal year) incurred essentially zero additional regulatory costs.[7] While much of the reduced regulatory burden identified by the administration can ultimately be traced to delays or paperwork reductions, the taming of the regulatory state has been remarkable. Congress also contributed to this effort by invoking the Congressional Review Act (CRA) to repeal 14 rules.[8]

Going forward, the Trump Administration has promised to make even more progress in reducing the burden of the regulatory state. For 2018, the administration produced a regulatory "budget" — the amount by which the nation's 24 regulatory entities' regulations are permitted to increase the overall cost of complying with regulations. These budgets, detailed by the American Action Forum's (AAF) Dan Bosch, show that overall deregulation will accelerate. Annualized costs are to decline by $687 million, or an up-front $9.8 billion.[9] Not all entities must deregulate equally. eight got budgets of zero – that is, flat overall regulatory burdens – while the remaining 16 got negative targets – that is, continued deregulation. Of note, nobody got an increase. Among the decreases, the largest is the Department of Interior, with $196 million in annualized reductions, or $2.8 billion in up-front costs.

The current administration should also be commended for enforcing a common method of measuring regulatory costs, especially by making sure that every regulatory entity uses comparable time periods over which to do the cost

accounting. The infrastructure of regulatory budgets and cost accounting have taken a very large step forward and will likely continue to evolve in the years to come.

Trade Policy

Trade is an important driver of productivity and economic growth in the United States and globally. Trade creates jobs, increases GDP, and opens markets to American producers and consumers. The United States is the world's largest participant in global trade – with over $2.3 trillion in exports of goods and services and imports of over $2.9 trillion – and has established trade agreements with 20 countries.[10] The United States is the largest exporter of services in the world.[11] Trade supports over 11 million jobs in the United States[12] and U.S. exports comprise nearly 13 percent of U.S. GDP.[13]

It is therefore regrettable that the Trump Administration has embraced protectionism at the expense of the opportunities that global trade provides. The administration walked away from the Trans-Pacific Partnership, which offered both economic and geo-strategic benefits. More recently and notably, the administration has decided to impose tariffs on steel and aluminum for dubious "national security" reasons. The national security rationale is undermined by the Department of Defense, which notes in a memo that the military's requirements for steel and aluminum can be met by a fraction of current domestic production.[14] Ultimately, these tariffs are likely to have the same effects of similar past actions – they will harm consumers, antagonize strategic and economic allies, and ultimately fail in their stated policy objections.[15]

Immigration Reform

Immigration reform can raise both population and labor force growth, and thus can raise GDP growth. In addition, immigrants inject entrepreneurialism into the U.S. economy.[16] New entrepreneurial vigor embodied in new capital and consumer goods promises a higher standard of living. Without this policy effort, low U.S. birth rates will result in a decline in the population and overall economy. An economically based immigration reform would raise the pace of economic growth substantially, raise GDP per capita, and reduce the cumulative federal deficit. It is therefore disappointing that the current administration has continued to pursue an immigration policy agenda that forgoes these benefits and threatens to diminish the effects of other pro-growth economic policies.

The Trump Administration has advocated restricting *legal* immigration, which is a sufficiently misguided policy as to earn the rebuke of nearly 1,500 economists, covering the spectrum of political preferences and including six winners of the Nobel Prize in Economics.[17] Restricting legal immigration would harm entrepreneurialism, accelerate the aging of the United States' demographics, and disqualify the U.S. economy as a home for the innovation and diversity of skills that immigrants bring. The current administration's chosen course of action with respect

to Deferred Action on Childhood Arrivals (DACA) also introduces needless policy risk to the economy. AAF's Jackie Varas estimates that "the average DACA worker contributes $109,000 to the economy each year. If all DACA recipients were removed, U.S. GDP would decrease by nearly $42 billion."[18] Put differently, the DACA population is an economic asset, and failure to address its uncertain status either through legislation or administrative action could undercut economic performance.

Structural Reforms to Enhance Trend Growth

The Unfinished Work of Tax Reform

The TCJA was an important first step in improving the U.S. tax code but should not be viewed as the final word in U.S. tax reform. Several features of the bill will need to be revisited and improved. Specifically, the temporary provisions should be made permanent. These include business and individual provisions, and expensing of qualified equipment should top the list of provisions that should be made permanent.

Making these changes permanent, however, should be done in a revenue neutral way. According to the President's Budget, just making the individual and estate tax provisions of the TCJA permanent would cost $541.6 billion over the next decade.[19] It would be fiscally imprudent to layer this additional deficit effect on top of existing budget challenges.

The Trump Administration and Congress, with the assistance of this Committee, should also continue the *reform* effort of tax reform and continue to flatten distortions in the tax code. The tax preference for debt over equity, for instance, persists in the tax code and should be revisited.

Entitlement Reform and a Sustainable Debt Trajectory

One of the biggest policy problems facing the United States is that spending rises above any reasonable metric of taxation for the indefinite future. A mini-industry is devoted to producing alternative numerical estimates of this mismatch, but the diagnosis of the basic problem is not complicated. The diagnosis leads as well to the prescription for action. Over the long-term, the budget problem is primarily a spending problem and correcting it requires reductions in the growth of the largest mandatory spending programs – namely, Social Security and federal health programs.

At present, Social Security is running a cash-flow deficit, increasing the overall shortfall. There are even larger deficits and future growth in outlays associated with Medicare, Medicaid, and the Affordable Care Act (ACA). These health programs share the demographic pressures that drive Social Security, but include the inexorable increase in health care spending per person in the United States.

For this reason, an immediate reform and improvement in the outlook for entitlement spending would send a valuable signal to credit markets and improve the economic outlook. The United States is courting a further credit downgrade as a sovereign borrower and the ensuing increase in borrowing costs such a downgrade would generate. Any sharp rise in interest rates would have dramatically negative economic impacts. Moreover, an actual liquidity panic would replicate (or result in a crash worse than) the economic contraction in the fall of 2008.

Alternatively, businesses, entrepreneurs and investors perceive the future deficits as an implicit promise of higher taxes, higher interest rates, or both. For any employer contemplating locating in the United States or expanding existing facilities and payrolls, rudimentary business planning reveals this to be an extremely risky environment.

But purely budget-driven arguments are insufficient to marshal support for entitlement reform. The large entitlement programs need reform in their own right. Social Security is a good example. Under current law, retirees will face a 23-percent across-the-board cut in benefits in less than two decades.[20] That is a disgraceful way to run a pension system. It is possible to reform Social Security to be less costly overall and financially sustainable over the long term.

Similar insights apply to Medicare and Medicaid, the key health safety nets for the elderly and poor. These programs have relentless appetites for taxpayer dollars yet do not consistently deliver quality outcomes. Reforms can address their open-ended draws on the federal Treasury and improve their functioning at the same time.

Growth-oriented fiscal strategy will re-orient spending priorities away from dysfunctional autopilot spending programs and toward core functions of government. It will focus less on the dollars going into programs and more on the quality of the outcomes. Such a strategy will do so because it is the principled approach, because it coincides with the best strategy to deal with the debt and growth dilemmas, and because it will force a restructuring of the entitlement programs to generate a quality social safety net.

In short, entitlement reform is a pro-growth policy move at this juncture. As summarized by AAF, research indicates that the best strategy both to grow the economy and to eliminate deficits is to keep taxes low and reduce public employee costs and transfer payments.[21]

Structural Regulation Reform

As noted above, the Trump Administration and Congress have made remarkable progress in halting the growth of the regulatory state and show promise in pursuing a regulatory agenda that should reduce net regulatory burdens. The remarkable progress on this front, however, underscores how quickly it could be reversed

under another administration. There remains a need for structural regulatory reform to check the growth of the regulatory state in the future.

The Regulatory Accountability Act (RAA) is one example of how Congress can impose structural checks on future burdensome regulations. Among other provisions, the Act defines a "high-impact" rule as a measure that would impose annual costs of $1 billion and require an advanced notice of proposed rulemaking for any high-impact rule. It would also require a public hearing before adoption and for agencies to adopt rules on the basis of the best evidence and the least cost to the economy. This is one of several potential legislative efforts that could improve checks on regulatory growth.

Education Reform

K-12 education is underperforming, and reform attempts have disappointed since No Child Left Behind passed. Our economy's future workforce is in crisis. Of 100 children born in 1983 who started kindergarten together in 1988, only 30 graduated on time in 2001. Of the 70 who eventually graduated, 50 started college, and just 28 of those 100 kindergartners had a college degree by spring of 2007. But it gets worse.

Our nation continues to report significant achievement gaps between students based on race and socioeconomic factors. On average, students of color have a much lower likelihood of graduating, at 76 percent. Of those who graduate, they typically exit high school with the functional equivalent of an 8th or 9th grade education. Despite more than $16 billion annually in targeted federal aid, our poor neighborhoods usually lack the essentials, such as good teachers. This achievement gap in the United States feeds an embarrassingly persistent and worsening gap between our students' performance and that of students in the rest of the industrialized world. The Organisation for Economic Co-operation and Development found that in 2012, America ranked 27th out of 34 industrialized countries in math and 20th in science.

In addition to the previously discussed policy areas, higher education requires significant reform . The amount of student loan debt has received a lot of attention, but how poorly these programs operate has received comparably little. The flaws are manifold: little-to-no meaningful underwriting at the time loans are issued, poor accounting for dollars once they are dispersed, and chronic underestimates of defaults and other taxpayer costs. In many fundamental ways, federal higher education policy looks remarkably similar to federal health policy, as both are marked by large open-ended subsidies, uneven quality, and inexorable cost growth. The federal programs that finance higher education need substantial reform, perhaps preceded by a needed assessment of the central value proposition those programs deliver.[22]

Combined, these reforms should be part of an overall workforce development agenda that also addresses other critical deficiencies in America's workforce. While these reforms cannot fully mitigate the demographic trends contributing to the relative decline of the labor force, they can meaningfully improve the prevailing economic trend and improve the nation's growth outlook.

Conclusion

Achieving more rapid trend economic growth is the most pressing federal policy issue. Fortunately, the roots of subpar growth are found in subpar growth policies. Focusing on permanent structural reforms to entitlement, tax, regulatory, immigration, education, and trade polices holds the promise of improving the economic outlook for this generation and those that follow.

Notes

[1] https://www.census.gov/library/publications/2017/demo/p60-259.html
[2] https://www.americanactionforum.org/research/does-compensation-lag-behind-productivity/; Also see https://www.bls.gov/opub/btn/volume-6/below-trend-the-us-productivity-slowdown-since-the-great-recession.htm on which figure 2 is based
[3] http://americanactionforum.org/research/economic-and-budgetary-consequences-of-pro-growth-tax-modernization
[4] 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
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[16] Holtz-Eakin, "Immigration Reform, Economic Growth, and the Fiscal Challenge."
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NATIONAL ASSOCIATION OF
Manufacturers

Leading Innovation. Creating Opportunity. Pursuing Progress.

Testimony

of Chad Moutray, Ph.D.
Chief Economist

National Association of Manufacturers

Before the Joint Economic Committee

On Unleashing America's Economic Potential

April 11, 2018

COMMENTS OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

BEFORE THE

JOINT ECONOMIC COMMITTEE

APRIL 11, 2018

Chairman Paulsen, Vice Chairman Lee, Ranking Member Heinrich and members of the Joint Economic Committee, thank you for the opportunity to testify on the economic impacts of tax reform. I will be tackling these issues from a manufacturing perspective.

The National Association of Manufacturers (NAM) is the nation's largest industrial trade association and voice for 12.6 million men and women who make things in America. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturers very much appreciate your interest in, and support of, the manufacturing economy.

I. Recent Economic Trends for Manufacturers

The latest NAM Manufacturers' Outlook Survey, released in December, showed a manufacturing sector with levels of optimism at unprecedented heights. In fact, 94.6 percent of respondents to our quarterly survey said they felt positive about their own company's outlook, the highest in the survey's 20-year history. Moreover, optimism has been at historically high levels across the past year, averaging 91.8 percent in the four quarters of 2017. To put that number in perspective, the average was 64.3 percent in 2016. In the December survey, respondents anticipated both sales and capital spending to increase over the next 12 months at the fastest rates since mid-2011, and employment continues to trend strongly upward.

What's behind those historic levels of manufacturer optimism? Primarily, pro-growth policies emanating from Washington—policies that would allow manufacturers to better compete in the global marketplace: smarter regulatory policies, for one, and the expectation that Washington would succeed in enacting historic tax reform.

Well, Congress did succeed in passing a historic package of tax reforms, which the president signed into law. We've seen the positive effects of this law throughout the economy already. And, while I cannot get into specifics right now, the NAM will release an update to its quarterly survey shortly, and from what we've seen already, it is safe to say that manufacturers remained very upbeat in the first quarter.

Indeed, the manufacturing economy has hit its stride over the past year, with solid growth in demand, output and hiring and a healthy outlook moving forward. Manufacturing production rebounded in February, up 1.2 percent for the month or 2.5 percent over the past 12 months. That was the best year-over-year rate since July 2014. Similarly, manufacturing capacity utilization jumped to 76.9 percent in February, a reading not seen since April 2008. At the same time, total industrial production rose 1.1 percent in February, or 4.4 percent, the highest rate since March 2011.

Improvements in the global economy have also helped to boost manufacturing in the United States, and trade volumes have risen significantly over the past year on the better outlook. In fact, international demand has started 2018 on a positive note, extending the rebound in 2017. U.S.-manufactured goods exports in January and February are 5.0 percent higher than at the same point last year, building on the 4.7 percent increase in 2017 as a whole. That turnaround is certainly an improvement from the declines of 6.2 percent and 4.0 percent in 2015 and 2016, respectively. Manufacturers have also benefited from a weaker dollar, which has boosted export demand.

With a brighter economic outlook, hiring has accelerated. Manufacturers added 22,000 workers in March, with employment in the sector rising by a rather robust 18,733 per month on average since the end of 2016. That is quite a turnaround from the sluggish job growth in 2016. Indeed, manufacturers cited the inability to attract and retain a quality workforce as the top concern in December's survey—the first time it has topped the list since the question was added in 2011. Since the end of the Great Recession, manufacturing employment has risen by 1,179,000 workers, with 12.63 million employees in the sector in March. That is the highest level of manufacturing employment since December 2008.

In my view, the U.S. economy should expand by 3.0 percent in 2018, the fastest pace of growth since 2005. Manufacturers should benefit from stronger economic growth globally, but it is also clear that businesses are responding positively to the passage of tax reform and the changed regulatory environment. In my own estimation, fixed investment in the manufacturing sector should rise by $55 billion this year, with employment increasing by another 104,000.

The rest of my testimony delves into those impacts and includes some examples about how tax reform is enabling manufacturers to invest more in their businesses and their people, helping to stimulate more economic growth.

II. Manufacturing Response to Tax Reform

As I will outline in more detail shortly, the recent tax reform law contained several provisions that provide significant benefits for many manufacturers, primarily:

- A corporate tax rate of 21 percent;
- A reduced tax burden on pass-through business income;
- A move toward an international territorial tax system;
- Robust rules for capital cost recovery; and
- A permanent R&D tax credit.

Prior to the passage of tax reform legislation late last year, U.S. corporations faced one of the highest statutory tax rates in the world. At 35 percent, the statutory rate was the highest in the Organisation for Economic Co-operation and Development (OECD) and the fourth highest in the world.[1] Public Law 115-97 **reduced the statutory corporate rate to 21 percent,** making the United States more competitive by bringing the top rate below the average of the G7 (29.57 percent), G20 (28.04 percent), OECD (24.18 percent) and the European Union (21.82 percent).[2]

[1] *See* Tax Foundation, Corporate Income Tax Rates around the World, 2017 (Sept. 7, 2017).
[2] *Id.*

In addition, the tax reform legislation included two provisions aimed at **reducing the tax burden on pass-through businesses, particularly those engaged in manufacturing.** The bill reduces the top individual income tax rate from 39.6 percent to 37 percent. Moreover, the legislation creates a new 20 percent deduction for pass-through business income. The ability to claim this deduction is limited based on the trade or business in which a taxpayer is engaged. The text of the bill indicates that manufacturers are not engaged in a "specified service" and are therefore eligible to claim the deduction. Moreover, as a taxpayer's income surpasses $157,500 ($315,000 in the case of taxpayers who are married and filing jointly), the ability to utilize the deduction turns either on wages paid or a combination of wages paid and basis in capital equipment. Capital-intensive industries, such as manufacturing, are uniquely positioned to benefit from this provision.

The tax reform legislation **moved the United States away from its decades-old "worldwide" system for taxing international income.** Under the old system, all earnings of a U.S. company were subject to U.S. tax, irrespective of the country in which it was earned. The old system allowed taxpayers to defer the imposition of this tax until earnings were brought back to the United States and allowed for a foreign tax credit to prevent double taxation. However, our high federal rates imposed a significant U.S. tax charge on repatriated earnings, resulting in what is often referred to as a "lockout" effect. The tax reform bill addressed this issue by moving toward a territorial tax system, in which foreign earnings are not subject to additional tax when brought to the United States. In transitioning to this new system, the bill imposes an immediate tax on previously unrepatriated foreign earnings. Moreover, the legislation imposes several anti-base erosion provisions to prevent taxpayers from transferring property offshore to significantly reduce their U.S. tax burden. The adoption of a new system for taxing foreign income raises substantial implementation questions, and manufacturers are engaging with the Treasury Department to work through these issues.

The NAM has long called for tax reform legislation that encourages the capital investment needed to ensure durable economic growth and job creation and promote U.S. productivity and competitiveness. The most effective way to spur business investment and make manufacturing in the United States more competitive is through a strong capital cost-recovery system and a full deduction for interest expense. The tax reform bill provides for **100 percent expensing for capital equipment acquisitions through December 31, 2022,** and phases this incentive out by 20 points per year over five years. In addition, the bill imposes new limitations on businesses' ability to deduct interest expense. Companies are only allowed to deduct an amount of interest that does not exceed 30 percent of earnings. Significantly, the earnings base to which the limitation applies will change. For taxable years starting after December 31, 2017, and before January 1, 2022, the 30 percent limit applies to earnings before interest, taxes, depreciation and amortization (EBITDA). For years starting after January 1, 2022, the limit applies to earnings before interest and taxes (EBIT). This shift will have the effect of further limiting interest deductions for industries that must invest in capital equipment, such as manufacturing.

Manufacturers account for more than three-quarters of all private-sector R&D in the United States. **While the tax reform bill retained the R&D tax credit, it also included provisions that will significantly diminish the value of the current deduction for R&D expenses in the coming years.** The bill would fundamentally modify the treatment of these expenses. For taxable years starting after December 31, 2021, these amounts would no longer be deductible in the year in which the expense was incurred. Rather, these costs would be

required to be capitalized and amortized over a period of five years (for domestic research expenses) or 15 years (for research conducted outside of the United States).

In sum, tax reform accomplished a lot of the NAM's long-sought goals. It lowered the marginal rate, making manufacturers in the United States more competitive globally. It reduced the tax burden for many pass-through entities, which account for more than 90 percent of NAM members. It moved the United States toward a territorial tax system, much like the rest of the world. And, it should encourage more dollars flowing back into the United States, expanding fixed investment and incentivizing more private-sector R&D.

While largely positive, tax reform could have gone further to support manufacturing, and I urge you to consider the following suggestions to do so. First, implementing a more robust incentive for pass-throughs would equalize the tax treatment of business income irrespective of the entity through which it is earned. Second, as noted above, the bill phases out full expensing starting in 2023, permanently modifies the treatment of currently deductible R&D expenses starting in 2023 and increases the cost of financing equipment purchases by limiting interest deductions to 30 percent of EBIT starting in 2022. These changes would serve as a disincentive to investment and innovation and should not take effect. Third, Congress should make clear that the Treasury Department has the authority to implement this new law in a manner consistent with its intent. This need is particularly urgent with respect to complex provisions in the international area. Fourth, Congress should continue to reevaluate the international competitiveness of our tax system. As noted above, our corporate income tax rate moved from one of the highest in the world to slightly better than average. Further reductions would serve to make the United States a more attractive place to start and grow a business.

The driving purpose behind tax reform was to create more opportunities for more Americans and to benefit manufacturing workers and their families directly. President Trump called tax reform "rocket fuel" for the economy, and manufacturers strongly agreed.

Prior to passage of tax reform, we asked NAM members what they would do if tax reform were enacted. Nearly 63 percent said comprehensive business tax reform would encourage their company to increase capital spending, and more than half would expand their business (57.9 percent) and hire more workers (53.8 percent), while nearly half would increase employee wages and benefits (48.8 percent).

Now that Congress and the president have done their part to pass pro-growth tax reform and make private-sector businesses more competitive, it is on those firms to deliver as well. Many businesses, including manufacturers, are already doing so by hiring more workers, creating more well-paying jobs and putting more money in the pockets of manufacturing workers. Indeed, nearly every day since the bill was enacted, there have been positive stories that underline these facts anecdotally. Here are just a few:

- Many of you will remember Steve Staub, the president and co-founder of Staub Manufacturing Solutions in Dayton, Ohio, as President Trump mentioned him during the State of the Union address. (If you do not remember him, you likely cannot forget Corey Adams, who has become the most famous welder in the country because of his appearance during the speech.) As a result of tax reform and pro-growth policies in general, Staub Manufacturing has hired 14 new team members, given each employee a pay raise and a larger bonus and expanded its operations by acquiring a building next door to increase its square footage.

- Miles Fiberglass in Oregon City, Oregon, has raised its entry-level wage by 9 percent in 2018, gave all employees a pay bump and will nearly double the size of its workforce. It is also using tax reform savings to design a new facility that will cut back on waste and increase energy efficiency.

- Centennial Bolt in Denver, Colorado, will increase its workforce by nearly 50 percent (from 27 employees to 39) and open a new plant in the Midwest. The company gave a Christmas bonus to all hourly workers totaling about 5 percent of their annual pay, doing so specifically because tax reform had been passed. It is also planning another bonus midyear and introducing profit-sharing to further benefit its employees.

- Windham Millwork in Windham, Maine, is planning to increase its workforce by 20 percent (from 80 employees to 100) and start a $1 million expansion of its facility. It also gave an immediate bonus of $1,000 to its hourly employees and across-the-board pay increases that the company said were a "direct result" of tax reform.

The NAM has highlighted many such tax stories on its blog, Shopfloor.org, and will continue to do so in the coming weeks.

In total, the investments stemming from tax reform will have large impacts on the U.S. economy. I have been working on a model to predict these impacts on the manufacturing sector. Based on my estimates, tax reform should lead to a $55 billion increase in private investment in fixed assets in manufacturing in 2018. That would represent an 11 percent increase over 2017 levels, with manufacturing employment rising by more than 100,000 as a result. In addition, we are in the process of surveying our membership on the impacts of tax reform, and we will release the findings of that analysis in the coming days.

III. Regulatory Relief

Executive Order 13771, often referred to as President Trump's "one-in, two-out" or "net-zero regulatory budget" order, has now been in effect for a little over a year. This executive order marks a significant change in regulatory philosophy compared to that of past presidents from both parties. In President Trump's first year, according to the Federal Register, federal agencies issued roughly half as many rule documents deemed significant under Executive Order 12866 than Presidents Bush and Obama issued in their respective first years.

In President Trump's first year in office, the administration published 23 deregulatory actions with estimated annualized cost savings, excluding those nullified under Congressional Review Act resolutions. Through the end of fiscal 2017, the administration completed 67 actions classified as deregulatory, including rules without estimated annualized cost savings. While these numbers are dramatic, they do not indicate a slash-and-burn approach to deregulation. Instead, they indicate a more methodical approach taking place through the rulemaking process. Perhaps the most noteworthy number through the end of fiscal 2017 is three: the number of new final rules with more than $100 million in burdens on the industry—a historic low.

This methodical approach, and dramatic slowdown in new rulemaking, has likely been an important component in record-high manufacturing optimism. Manufacturers do best when regulatory conditions are certain and stable, because fast-paced and dramatic regulatory or deregulatory actions may introduce new variables and risks into their operations. Simply slowing

down discretionary agency actions appears to have had a greater impact than the projected net decrease in per-capita regulatory burdens.

In the NAM's Manufacturers' Outlook Survey, the business climate has continued to diminish as a top concern. This reordering of top concerns mainly reflects manufacturers' recognition that a dramatic change in the policymaking environment has occurred in Washington since the 2016 election. In addition to tax reform, there was a regulatory moratorium last year—a dramatic shift in the federal rulemaking process and one that manufacturers see widely as a positive development.

Manufacturers believe that regulation is critical to the protection of worker safety, public health and our environment. At the same time, our regulatory system needs improvement. We need smarter regulations that minimize unnecessary burdens and better balance benefits and costs, eliminating redundancies wherever possible. Regulations can accumulate with no real effort to evaluate or clean up the outdated and obsolete rules already on the books. It is imperative that policymakers and regulators understand the cumulative burdens that their rules are placing on businesses and enact policies that minimize those costs that do not contribute to the realization of regulatory objectives.

One of the reasons to reform the regulatory process is to acknowledge that burdens are not evenly distributed. Certain sectors, such as manufacturing, bear a sizeable portion of overall regulatory costs in the economy. In addition, small and medium-sized manufacturers experience the burdens of regulation that are significantly greater than their larger counterparts. They lack the economies of scale that larger businesses rely on to spread the costs of compliance. Each dollar that a small or medium-sized manufacturer spends on regulatory compliance is a dollar that the company cannot spend to grow its business or expand its workforce.

We asked our manufacturing members about how the changed regulatory environment has impacted their businesses. More than 38 percent of respondents said that the better rulemaking climate will allow them to increase capital spending and expand their businesses, with roughly 35 percent noting that they could increase employee wages and benefits and hire new workers.

Moving forward, there is also a desire to further reform the way that federal rulemaking is done, hopefully streamlining the process and better including business feedback. We asked respondents if they generally have enough time to understand new regulations before those rules become effective or mandatory, and 54.6 percent said they did not. Nearly 19 percent noted they had been accused of violating a regulatory provision they did not realize applied to them or they did not realize existed. Beyond the awareness issue, nearly 47 percent indicated they have delayed an investment due to uncertainties related to regulations.

IV. Start-Up Rates and the Business Climate

Beyond these issues, I know this committee has focused heavily in recent hearings on declining entrepreneurship rates. I should note that I used to be the chief economist at the Office of Advocacy for the U.S. Small Business Administration, and as such, this is an issue that I care about greatly. Like the broader economy, new manufacturing establishment start-up rates have fallen since the 1990s, and in my view, the business environment plays a large role in helping to explain firm formation rates, especially for those start-ups with employees.

The best way to increase firm formation is to have a growing economy. Policymakers need to adopt pro-growth measures that will enable manufacturers and other businesses to expand, to hire more workers and to invest in more capital spending. A healthy economy will encourage more participants, and that should spur more entrepreneurship and innovation. The recently enacted tax changes and the improved regulatory climate should help to enhance firm formation moving forward. With that said, there is still more that can be done, including adopting other pro-growth measures.

The NAM continues to push for more infrastructure investment, to have a fully functioning Export-Import Bank and for more avenues to enhance workforce development. At the same time, we also do not want to discourage growth by creating economic uncertainties in the marketplace, including on trade matters. The main goal for international trade negotiations should, first and foremost, be to increase opportunities wherever we can, raise standards and ensure strong and binding enforcement tools.

Along those lines, with NAFTA, we have a critical opportunity—depending on the choices we make, we can either boost this growth further or put it all at risk. That is why it is so important to get NAFTA modernization done the right way. President Trump is correct that it is time to make NAFTA better. We at the NAM have put forward a 10-point plan to improve market access, raise standards to improve our competitiveness and strengthen enforcement tools to hold our trading partners accountable. He knows the stakes for the economy, jobs and the stock market if we get this wrong.

V. Conclusion

Chairman Paulsen, Vice Chairman Lee, Ranking Member Heinrich and members of the Joint Economic Committee, thank you for your leadership on the economy and business competitiveness and for holding this hearing.

Manufacturers are benefiting from a growing U.S. and global economy, and strong expansions in demand, output and hiring in 2017 have carried over into 2018—at least so far. The NAM's quarterly survey has recorded its highest levels of optimism in the economic outlook in its 20-year history, and manufacturing production has risen 2.5 percent year-over-year, the fastest rate since July 2014. Workforce challenges top the list of primary concerns for firms of all sizes across the country. Indeed, nearly every manufacturer that I talk to tells me that they are having difficulties finding talent. Along those lines, there were 427,000 job openings in the sector in January—not far from an all-time high.

Pro-growth policies—including tax reform and a changed regulatory climate—have helped to boost economic growth. Manufacturers are benefiting from the improved business environment, which is helping to make the sector more competitive globally. Congress and the president did their part when it comes to tax reform, and the NAM continues to strongly urge its members to continue doing their part as well. Fortunately, we continue to hear positive stories about how tax reform has helped businesses invest more, hire more and pay more to their employees. From my own analysis, I expect fixed investment in the manufacturing sector to rise by $55 billion this year because of the tax law changes.

Therefore, these policies have also enhanced the outlook for a stronger macroeconomy, and I remain bullish about the prospects for growth in the manufacturing sector and for the larger economy. It is important for the president and Congress to look for other ways to enhance competitiveness and pass other pro-growth policies to ensure that our bright prospects can come to fruition. That is—I know—the goal of this committee as well.

Testimony of Richard Hampton
Chairman of the Board, Circuit Interruption Technology Inc.
Hearing before the Joint Economic Committee
"Unleashing America's Economic Potential"

April 11, 2018

Chairman Paulsen, Ranking Member Heinrich, and members of the Committee, thank you for this opportunity to testify on "Unleashing America's Economic Potential" through the perspective of one small but growing family-owned business in Rogers, Minnesota.

Our Company

My name is Rick Hampton, and I am Chairman of the Board of Circuit Interruption Technology, Inc. CIT is truly a family business. It was started in 1999 by my son, Jeffrey, shortly after he graduated from Metropolitan State University business school. Jeff, who is here with me today, was an entrepreneur from an early age. In junior high he sold gum out of his locker. In high school, he started a very successful lawn and landscaping business. That financed his way through college and provided seed money to start CIT. CIT began in my home, staffed by Jeff and my wife Sharon. It moved from selling fuses and circuit breakers to a line of business I had experience with, electro-mechanical relays and switches. We now do business as CIT RELAY & SWITCH.

For a variety of reasons, there are virtually no manufacturers of our kind of products left in America, so we contract with manufacturing facilities in China and Korea. Our engineering staff creates the design in consultation with Asian engineering affiliates. CIT is committed to the highest quality possible. Our specifications frequently exceed those of our competition, making CIT often the first choice in critical or problem applications. Our employee base continues to grow in all sectors of our business. We also support other jobs, including 94 independent sales representatives, and sell through nearly 100 distributor locations throughout the United States.

Our customers are mostly North American original equipment manufacturers, many of which are household names. Our relays and switches are used in countless products you'll find in your home, office, on the road, in restaurants or parking lots, or even on aircraft carriers. When you send your child off to school on a "Yellow Bus," start your washer or dishwasher, drive on a golf course, or mix your favorite health drink, you may well be depending upon a quality CIT product.

Today, my son is President and CEO, I am Chairman of the Board, my wife Sharon is Chief Financial Officer, and my daughter Nicole—a successful businesswoman in her own right—handles International Distribution and Sales Management. Four years ago we moved from a smaller facility in Spring Lake Park to a larger facility in Rogers, and since then we have expanded from 12 to 22 employees. We invest in our employees, paying them well, helping them advance professionally, and even helping them through rough patches in their lives.

Pre December 2017 Tax Consequence:

The long-term drag of a burdensome tax system likely played a role in the migration of relay and switch manufacturing from North America to Asia and mostly China. Other factors involved cheap labor and low regulatory burdens. The migration accelerated as China aggressively sought manufacturing facilities and technology transfers. Fewer component part suppliers remained in America, driving up costs. Inevitably, this was followed by fewer technical personnel skilled in production.

Manufacturing and the transfer of technical know-how enabled China to become skilled in metallurgy, magnetics, polymers, and other elements of sophisticated manufacturing.

All the while, the high average tax on CIT profits resulted in a less-than-desirable business approach from an accounting standpoint. Essentially, the tax system punished us for keeping profits in the company.

As a family-owned business it was clear that $1.00 in profit would be subject to an initial corporate tax of 37%; followed by roughly another 37% Federal personal tax when it was taken out as income, and another 8% in Minnesota State tax, leaving us with less than 35 cents of the original $1.00. To avoid this double taxation professional accountants agreed the best approach would be to take out 100% of the profit, subject it to a one-time Federal and State personal tax, which would retain more than 50% of the original dollar. Those net dollars could then be re-invested in the company. The negative impact of this approach was highlighted recently when CIT applied for an expansion of its credit card line of credit. Due to what appeared to be low income on sales of $10,000,000, the credit company denied our request. The re-invested dollars were clearly shown on our balance sheet but were seen as a CIT liability, not retained earnings.

December 22, 2017, Tax Reform Changed our Business Model

CIT made a plan in the event tax reform actually became law. We determined that we would:

- Provide a bonus of one extra week pay to all employees;
- Fund our employee 401K program with no matching required at 5% of employee 2017 W-2 income, including the bonus;
- Launch a lab and facilities construction program estimated between $140,000~$200,000;
- Increase our employee base by 10%;
- Extend a $1000 bonus to employees achieving their 10-year milestone of employment;
- Establish a fund to evaluate the possibility of bringing manufacturing back to America; and
- Changing our budgeted forecast from 5% growth to 15% in 2018

All of the above have been implemented. We are now projecting additional changes in the near term:

- We will retain 2018 profit in the business, meaning that after tax we will be able to keep 79% of the profit as retained earnings in the company.
- We anticipate expanding hiring by another 10% by year's end.
- We anticipate repeating the 5% 401K contribution and extra one-week year-end bonus.
- We are projecting 30% growth 2019.

Additional Thoughts on Manufacturing Our Products in America

While tax reform was great news, the remaining barriers to manufacturing our products in America are two-fold:

- CIT would need to compete with companies receiving direct assistance and subsidies from the China government.
- We would have to navigate the plethora of regulations from various domestic County, State and Federal agencies.

We think that CIT specialization and quality can meet the first challenge. The second, however, is more daunting as the unknowns become known only through the process of re-introducing manufacturing in America. The ultimate cost may be unknowable until far along in the process, making this barrier the most frightening of all; for a small business such as ours taking such a risk could even lead to the very extinction of the Company.

Tariffs

Since tariffs are in the news and have a direct effect on CIT let me say a word about the proposed tariff on relays in particular. As there are virtually no general-line relay manufacturers remaining in the United States, here is how I assess the potential impact:

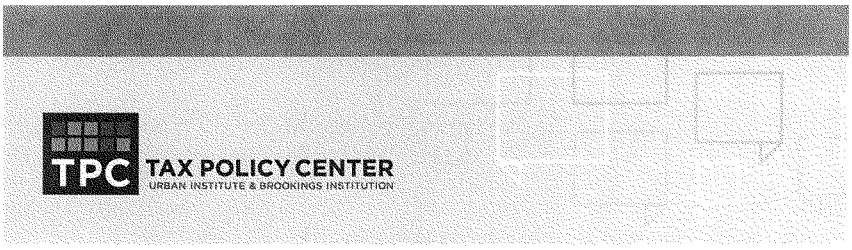
1. The affected products are broad. The average automobile uses over 20 relays. In addition to all vehicle types they are used in computers, security, thermostats, furnaces, humidifiers, appliances such as washers and dryers, industrial and restaurant ovens, heating and air conditioning, as well as medical and military uses. There are simply too many product applications to mention.
2. An exclusive China tariff will provide a corresponding competitive edge to relay manufacturers currently located in Canada, Mexico, and Europe, providing them a 25% price advantage and potentially damaging CIT's ability to survive.
3. A specific China manufacturer with a solid foothold in the United States is State-Owned and thus any tariff may be potentially reimbursed to this China manufacturer, allowing them to maintain price while CIT must increase theirs 25%, resulting in an unintended consequence of increasing the growing dominance of China over this critical component.

Conclusion

While companies like CIT Relay & Switch continue to face a host of regulatory and other challenges, tax reform has been and will continue to be a tremendous help to our business and employees. We are in the process of developing a longer term approach to expanding our business model from private-label manufacturing outside the United States to re-shoring manufacturing in America. In conjunction with this approach CIT will be hiring added technical staff to help explore this process. We'll hire additional staff to expand new products, some of which will meet the demand for relays to support electric automobile charging stations and specialty relays used to reduce energy used for office lighting. CIT will take the necessary steps to position itself to meet the growing desire by our customers for US-made quality and improved logistics that ultimately result from domestic US manufacturing.

I believe the lower tax will allow CIT Relay & Switch to position itself for continued growth for the coming decade. More might be done, but this historical change alone is energizing and exciting to all our team, employees and management alike.

Thank you again for this opportunity to testify, and I look forward to any questions you may have.



REFLECTIONS ON THE TAX CUTS AND JOBS ACT

Mark J. Mazur*
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Joint Economic Committee
Hearing on "Unleashing America's Economic Potential"

April 11, 2018

*The views expressed are my own, and should not be attributed to the Urban Institute, the Brookings Institution, the Tax Policy Center, their trustees or their funders.

I want to start by thanking Chairman Paulsen and Ranking Member Heinrich and all the members of the Committee for inviting me to participate in this important hearing.

Given my position and background, my testimony focuses primarily on fiscal issues, with particular emphasis on the recently enacted Tax Cuts and Jobs Act (TCJA). How we as a nation ensure a thriving economy in which all can participate along with fiscal responsibility are key issues. Obviously, none of us want to burden future generations with the financial results of our choices today. Rather, we should strive to provide our children and grandchildren with better sets of economic choices than we had provided to us.

The Tax Cuts and Jobs Act was the most consequential tax overhaul in three decades. The new law contains several major structural changes to our tax code and many other nonstructural changes. These all will have a variety of economic implications. Some of these implications are clear and fairly well known. Others are much less clear and involve trade-offs among conflicting goals or are contingent on future legislation or future economic behavior or future reactions by other countries. And some implications are just inherently uncertain given the state of economic knowledge.

As a starting point for evaluation, consider the four basic tenets of good tax policy:

- Revenue adequacy: Tax systems should raise enough revenue to meet the current and future obligations of the government (rather than to meet the demands from citizens for public goods and services).
- Efficiency: Tax systems should raise that revenue in a way that minimalizes negative effects on resource allocation, underlying economic behavior, and economic growth prospects.
- Equity: Tax systems should raise that revenue in a way that citizens find to be fair. In general, this means that the tax system exhibits horizontal and vertical equity. Horizontal equity means that taxpayers with similar incomes are treated in a similar manner by the tax system. Vertical equity means that taxes are assessed on a taxpayer's ability to pay tax, which usually is characterized as a progressive tax system—one where tax liabilities as a share of income tend to increase with income.
- Simplicity: Tax systems should be as simple as possible so taxpayers understand the consequences of their economic decisions and so there are fewer unintended consequences. Generally, this means that tax laws and rates are clear, comprehensible, and predictable.

In the real world these policy goals all involve trade-offs. There are an infinite number of transactions that taxpayers can enter into, and so laws will never be simple. Similarly, raising adequate revenue requires trade-offs related to efficiency and equity. But if one keep these policy goals in mind, it becomes possible to evaluate changes in tax law qualitatively as well as quantitatively.

CLEAR EFFECTS OF TCJA

There are several effects of the Tax Cuts and Jobs Act that are quite clear. First, there is a large tax cut in the short term. According to the Joint Committee on Taxation, the nonbusiness individual income tax provisions will cost around $60 billion in FY 2018 and around $160 billion in FY 2019. The business provisions have a similar revenue cost. So, to a first approximation, this is a large, stimulative tax cut in the short term.

And these tax cuts are tilted toward those with the highest incomes. Tax Policy Center estimates indicate that the short-term tax cuts as a share of after-tax income increase throughout the population as income gets higher. We estimate that the 20 percent of the income distribution with the lowest incomes will benefit by about $60 per year on average, or about 0.4 percent of average after-tax income. In contrast, those in the top 20 percent of the income distribution with the highest incomes receive an average tax cut of more than $7,600, or 2.2 percent of their average after-tax income.

TABLE 1

Distribution of Federal Tax Change of the Conference Agreement for the Tax Cuts and Jobs Act

By expanded cash income percentile, 2018[a]

Expanded cash income percentile[b]	Percent change in after-tax income[c]	Share of total federal tax change (%)	Average federal tax change (dollars)	Average federal tax rate[d]	
				Change (% points)	Under the proposal (%)
Lowest quintile	0.4	1.0	-60	-0.4	3.7
Second quintile	1.2	5.2	-380	-1.1	7.6
Middle quintile	1.6	11.2	-930	-1.4	12.4
Fourth quintile	1.9	18.4	-1,810	-1.6	15.8
Top quintile	2.9	65.3	-7,640	-2.2	23.3
All	2.2	100.0	-1,610	-1.8	18.1
Addendum					
80-90	2.0	13.1	-2,970	-1.6	18.5
90-95	2.2	9.6	-4,550	-1.8	20.2
95-99	4.1	22.1	-13,480	-3.1	22.2
Top 1 percent	3.4	20.5	-51,140	-2.3	30.3
Top 0.1 percent	2.7	7.9	-193,380	-1.8	31.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1)

Notes: Number of Alternative Minimum Tax (AMT) taxpayers (millions): Baseline: 5.2; Proposal: 0.2. Itemizers (millions): Baseline: 46.5, Proposal: 19.3.

(a) Calendar year. Baseline is current law. Proposal includes provisions contained in the conference agreement for the Tax Cuts and Jobs Act as filed on 12/15/2017. Excludes the effects of repealing the Affordable Care Act's Individual Shared Responsibility Payment (i.e., "individual mandate").

(b) Percentiles include both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2017 dollars): 20% $25,000; 40% $48,600; 60% $86,100; 80% $149,400; 90% $216,800; 95% $307,900; 99% $732,800; 99.9% $3,439,900. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm

(c) After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate tax; and excise taxes.

(d) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

In the longer term, the Tax Cuts and Jobs Act becomes even more regressive. By 2027, we expect the legislation to provide a small net tax cut on average. But the 60 percent of the population with lower incomes would experience, on average, a net tax increase under the law as written. This is because most of the individual

income tax cuts will have expired, and the substitution of a slower-growing price index to adjust for inflation will gradually raise taxes on individuals, compared to earlier law. The portion of the population receiving net tax cuts is primarily those with the highest incomes and those with capital income, who benefit from the ongoing corporate income tax cuts.

TABLE 2

Distribution of Federal Tax Change of the Conference Agreement for the Tax Cuts and Jobs Act

By expanded cash income percentile, 2027[a]

Expanded cash income percentile[b]	Percent change in after-tax income[c]	Share of total federal tax change (%)	Average federal tax change (dollars)	Average federal tax rate[d]	
				Change (% points)	Under the proposal (%)
Lowest quintile	-0.1	-4.6	30	0.1	4.4
Second quintile	-0.1	-5.4	40	0.1	8.9
Middle quintile	0.0	-2.1	20	0.0	13.8
Fourth quintile	0.0	2.9	-30	0.0	16.9
Top quintile	0.4	107.3	-1,260	-0.3	26.0
All	0.2	100.0	-160	-0.1	20.0
Addendum					
80-90	0.1	4.4	-100	0.0	19.7
90-95	0.1	3.9	-190	-0.1	21.8
95-99	0.2	16.4	-1,010	-0.2	25.4
Top 1 percent	0.9	82.8	-20,660	-0.6	32.9
Top 0.1 percent	1.4	59.8	-148,260	-0.9	32.9

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1)

Notes: Number of Alternative Minimum Tax (AMT) taxpayers (millions): Baseline: 5.6; Proposal: 6.0. Itemizers (millions): Baseline: 56.8, Proposal: 57.4.

(a) Calendar year. Baseline is current law. Proposal includes provisions contained in the conference agreement for the Tax Cuts and Jobs Act as filed on 12/15/2017. Excludes the effects of repealing the Affordable Care Act's Individual Shared Responsibility Payment (i.e., "individual mandate").

(b) Percentiles include both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2017 dollars): 20% $28,100; 40% $54,700; 60% $93,200; 80% $154,900; 90% $225,400; 95% $304,600; 99% $912,100; 99.9% $5,088,900. For a description of expanded cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm

(c) After-tax income is expanded cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); estate tax; and excise taxes.

(d) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, the estate tax, and excise taxes) as a percentage of average expanded cash income.

A second clear effect of the Tax Cuts and Jobs Act is that the vast majority of tax cuts for individual taxpayers are temporary, and the tax cuts for businesses (especially corporate income) tend to be permanent. However, a number of the investment provisions for business, such as bonus depreciation, are temporary. And a reduction in the incentive to invest in research and development is scheduled to start in 2022.

A third clear effect is shifting the system for taxing US-based multinational corporations in a direction similar to many of our trading partners. The prior tax system had been described as "worldwide taxation with deferral," but the ability of many cash-rich US multinationals to defer recognizing income from their foreign subsidiaries indefinitely meant that the tax system really functioned as a hybrid between a worldwide and a territorial tax system (where only income earned in the US would be subject to US taxation).

A fourth clear effect is a shift away from a broad-based, lower-rate income tax system in two ways. One way is in the direction of a hybrid tax system with more consumption tax aspects. By embracing 100 percent bonus depreciation, at least temporarily, Congress moved the business tax system toward a consumed income tax. Similarly, by denying deductions for net operating losses and for items that are costs of producing income, such as interest payments, FDIC premiums, housing expenses, and certain corporation expenses, the Tax Cuts and Jobs Act moves away from a traditional income tax base.

A fifth clear effect is the further establishment of different tax systems for different taxpayers. The Tax Cuts and Jobs Act maintained the preferential income tax rates for long-term capital gains and for dividends. But it added new tax regimes for income from pass-through entities (many of which are smaller businesses, but some of which are very large entities) that provide lower tax rates than for comparable wage earners, for income from exports by US multinational firms, and added a Base Erosion Anti Abuse Tax on certain intra-company transactions with foreign affiliates.

And the final clear effect I want to highlight is that the Tax Cuts and Jobs Act represents a large fiscal experiment, especially when considered in conjunction with the budget bill enacted in January. Taken together, these legislative efforts reduce federal revenues by $1.5 to $2 trillion over the 10-year budget window, under conventional federal budget scorekeeping methods. This large reduction in future revenues occurs at a time when the US economy is at or near full employment, so there is little need for added economic stimulus and the medium- and long-term pressures on the federal budget are likely to grow. The reason I call this an experiment is that proponents of the tax cuts contained in the legislation claim that they will have positive effects on the overall US economy and that economic growth will help improve the Nation's Fiscal outlook. But this is an untested claim.

LESS-CLEAR EFFECTS OF THE TCJA

Conventional macroeconomic analysis indicates that the positive economic effects of the Tax Cuts and Jobs Act are likely to be small for the bill as written. This is because many of the investment incentives are temporary, as are most of the individual income tax provisions. In the longer term, the positive economic effects will be driven by a lower corporate tax rate, largely paid for by individual income tax increases because of a change in the price index used to adjust individual income tax parameters for inflation and less federal support for health care coverage because the individual penalty for not obtaining adequate health insurance is set to zero.

The macroeconomic analyses conducted on the Tax Cuts and Jobs Act by the Tax Policy Center, the Penn Wharton Budget Model, and the Congressional Joint Committee on Taxation all come to similar conclusions. There is an initial burst of extra economic growth as households and firms deploy the initial round of tax cuts. There may even be additional capital investment above what would have occurred in the absence of legislation because of improved investment incentives. But over time, larger federal budget deficits cause interest rates to tick up, providing a disincentive for firms to invest. This later effect erodes the initial burst of economic growth,

and, within a decade or so, the overall economy is back to about where it would have been without the tax law changes.

To trigger strong positive economic growth, a number of effects need to occur through linkages among economic actors. To sketch out how this might work, consider the following possible set of effects. A lower corporate income tax rate makes investments in the United States more attractive because of a higher after-tax rate of return. More investment capital for business entities encourages them to add to their stock of productive capital. In turn, this means that workers are more productive and the increased output is sold to willing consumers. This increased productivity leads to firms competing for the now more-productive workers, increasing wage rates commensurately. Each of these linkages is uncertain as to its strength, which is why I characterize this tax overhaul as a large fiscal experiment. In similar situations in the past, the promised additions to economic growth have not materialized. But those who support the Tax Cuts and Jobs Act on economic grounds have argued that this time will be different.

The Tax Cuts and Jobs Act also will have some effect on overall complexity of the Tax Code, but different provisions push in different directions, so the overall effect is unclear. There are a number of provisions that certainly will increase complexity, notably the changes to the way income from multinational firms is taxed, the changes to the way that income from certain pass-through business entities is taxed, and the creation of a new geographically-based investment incentive called Opportunity Zones. There also are several provisions that likely will reduce complexity for many taxpayers, such as the large increase in the standard deduction amount under the individual income tax, which will reduce the number of taxpayers claiming itemized deductions by millions, reducing complexity and record-keeping burden for these taxpayers. In the area of business taxation, repealing the domestic production activities deduction and introducing simplified accounting methods for smaller businesses should make complying with the income tax a bit easier for many businesses.

The Tax Cuts and Jobs Act also will have mixed effects on tax system certainty. It is true that many taxpayers will experience tax cuts for 2018 and 2019. But the new law also brings a lot of uncertainty. A chief reason is the built-in phase-outs, phase-ins, rate changes, and other scheduled changes that are part of the Tax Cuts and Jobs Act. This includes the favorable treatment for medical expense deductions and the lower excise tax rates on some production by alcoholic beverage producers. And there is the scheduled expiration of most individual income tax provisions after 2025, including the preferential tax treatment for income from pass-through businesses. For companies making long-term investments and having to choose their form of operating entity and the size and scope of their investment activity, making these choices with the prospect of wholesale changes in the tax law is a daunting task.

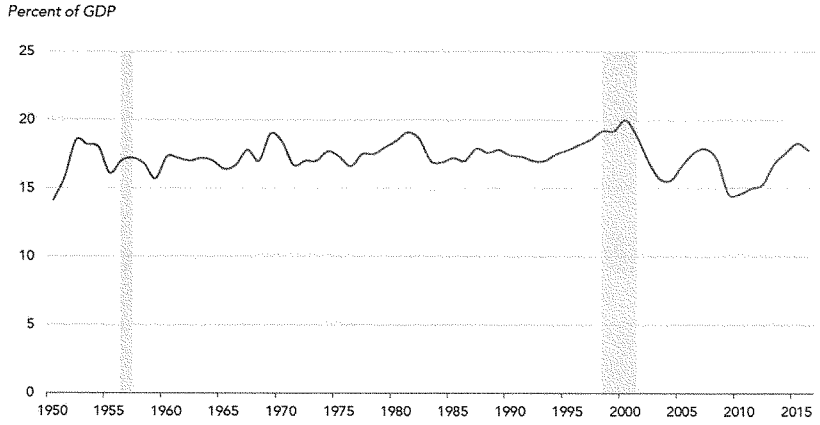
There also is some added uncertainty because of the speed with which the tax bill was enacted. Both the international tax provisions and the special tax regime for pass-through businesses were enacted without the chance for outside experts to analyze and evaluate design choices. That rapid legislative process means that US Department of the Treasury and the IRS will have to issue detailed regulatory guidance to explain how these

provisions will operate in practice. The uncertainty surrounding the outcomes of these regulatory decisions and the speed with which they can be delivered adds to the uncertainty for affected parties.

IMPACT ON FISCAL POSITION OF THE TCJA

The following chart shows federal revenues over the last 65 years or so. Despite changes in the economy, tax laws, and the political climate, federal revenues have fluctuated in a fairly narrow band—between 15 and 20 percent of GDP.

Total Federal Receipts as a Share of National GDP
1950-2016



Source: Office of Management and Budget, Fiscal Year 2018, Historical Tables, Table 2.3.

But only two periods since 1950 have seen a balanced federal budget (the shaded areas in the chart). The more recent period was the late 1990s/early 2000s when revenues were around 20 percent of GDP. Given demographic trends (aging Baby Boomers, longer lifespans, relatively low birth rates), we can expect the public's demand for goods and services to be at least as high as it was during that time frame. So balancing the federal budget is likely to require federal revenues at least approaching 20 percent of GDP. The Tax Cuts and Jobs Act, as a net medium-term tax cut, goes in the opposite direction.

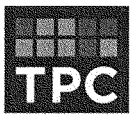
CONCLUSIONS ABOUT THE TCJA

The recent tax overhaul contains both desirable and undesirable features. It included a necessary updating of the tax system applied to multinational firms. And it simplified tax filing for millions of individuals by substantially increasing the standard deduction and reducing the number claiming itemized deductions.

But the Tax Cuts and Jobs Act also has some negative features. It will worsen income inequality in the short and long run by reducing the overall progressivity of our tax system. It added several new complexities to the tax code while adding considerable uncertainty about how the law will be interpreted and administered and also whether various provisions will phase in, phase out, sunset, or come into being as scheduled. And the Tax Cuts and Jobs Act reduces tax revenues at a time when fiscal pressures and economic conditions indicate that may have negative consequences.

THE PATH FORWARD

As with any new tax legislation, there will be a lot of interest in seeing its effects on the economy and on federal receipts. There will be opportunities to make necessary and desirable fixes to the legislation as defects become apparent. And Congress will have numerous opportunities to evaluate and reevaluate this legislation as provisions sunset, or phase down, or spring up. For example, at the end of 2019, the modification to the medical expense deduction (lowering the threshold to 7.5 percent of adjusted gross income) and the lower excise taxes on certain alcoholic beverage production will sunset. After 2022, the bonus depreciation provision begins to phase down and it sunsets in 2026. And most individual income tax provisions and the estate tax cuts expire after 2025. A number of other provisions have similar scheduled changes under the new law. Each of these will provide Congress with a good opportunity to evaluate how the provisions are working (or have worked) and to make a well-considered decision about whether the scheduled legislative treatment should be modified. And those decisions will have important implications.



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The Washington Post

A DEBT CRISIS IS COMING. BUT DON'T BLAME ENTITLEMENTS.

BY MARTIN NEIL BAILY, JASON FURMAN, ALAN B. KRUEGER, LAURA D'ANDREA TYSON, AND JANET L. YELLEN

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Martin Neil Baily, Jason Furman, Alan B. Krueger, Laura D'Andrea Tyson and Janet L. Yellen are all former chairs of the White House Council of Economic Advisers.

The U.S. unemployment rate is down to 4.1 percent, and economic growth could well increase in 2018. Consumer and business confidence is high. What could go wrong?

A group of distinguished economists from the Hoover Institution, a public-policy think tank at Stanford University, identifies a serious problem. The Federal budget deficit is on track to exceed $1 trillion next year and get worse over time. Eventually, ever-rising debt and deficits will cause interest rates to rise, and the portion of tax revenue needed to service the growing debt will take an increasing toll on the ability of government to provide for its citizens and to respond to recessions and emergencies.

None of that is in dispute. But the Hoover economists then go wrong by arguing that entitlements are the sole cause of the problem, while the budget-busting tax bill that was passed last year is described as a "good first step."

Entitlement programs support older Americans and those with low incomes or disabilities. Program costs are growing largely because of the aging of the population. This demographic problem is faced by almost all advanced economies and cannot be solved by a vague call to cut "entitlements"—terminology that dehumanizes the value of these programs to millions of Americans.

The deficit, of course, reflects the gap between spending and revenue. It is dishonest to single out entitlements for blame. The Federal budget was in surplus from 1998 through 2001, but large tax cuts and unfunded wars have been huge contributors to our current deficit problem. The primary reason the deficit in coming years will now be higher than had been expected is the reduction in tax revenue from last year's tax cuts, not an increase in spending. This year, revenue is expected to fall below 17 percent of gross domestic product—the lowest it has been in the past 50 years with the exception of the aftermath of the past two recessions.

All of us have supported corporate tax reform. The statutory tax rate was too high, much higher than in other Organization for Economic Cooperation and Development economies. However, because of deductions and breaks in the tax code, the effective marginal tax rate was similar to the average among competitor economies. The right way to do reform was to follow the model of the bipartisan tax reform of 1986, when rates were lowered while deductions were eliminated.

Instead, the tax cuts passed last year actually added an amount to America's long-run fiscal challenge that is roughly the same size as the preexisting shortfalls in Social Security and Medicare. The tax cuts are reducing revenue by an average of 1.1 percent of GDP over the next four years. The Hoover authors minimized the cost of the tax cuts by noting that if major provisions are allowed to expire on schedule—certainly an open question, given political realities—they would amount to "only" 0.4 percent of GDP. Even this magnitude exceeds the Medicare Trustees' projections of a 0.3 percent of GDP shortfall in Medicare hospital insurance over the next 75 years.

Just as entitlements are not the primary cause of the recent jump in the deficit, they also should not be the sole solution. It is important to use the right wording: The main entitlement programs are Social Security, Medicare, veterans benefits, and Medicaid. These widely popular programs are indeed large and projected to grow as a share of the economy, not because of increased generosity of benefits but because of the aging of the population and the increase in economywide health costs.

There is some room for additional spending reductions in these programs, but not to an extent large enough to solve the long-run debt problem. The Social Security program needs only modest reforms to restore its 75-year solvency, and these should include adjustments in both spending and revenue. Additional revenue is critical because Social Security has become even more vital as fewer and fewer people have defined-benefit pensions. Medicare has been a leader in bending the health-care cost

curve. Reforms to payments and reformed benefit structures in Medicare could do more to hold down its future costs.

As we focus on the long-run fiscal situation, our goal should be to put the debt on a declining path as a share of the economy. That will require running smaller deficits in strong economic periods—such as the present—to offset the larger deficits that are needed in recessions to restore demand and avoid deeper crises. Last year's Tax Cuts and Jobs Act turned that economic logic on its head. The economy was already at or close to full employment and did not need a boost. This year's bipartisan spending agreement contributed further to the ill-timed stimulus. The Federal Reserve will have to act to make sure the economy does not overheat.

Several years ago, there was broad agreement that responding to the looming fiscal challenge required a balanced approach that combined increased revenue with reduced spending. Two bipartisan commissions, Simpson-Bowles and Domenici-Rivlin, proposed such approaches that called for tax reform to raise revenue as a percent of GDP and judicious spending cuts. Without necessarily agreeing with these specific plans, we believe a balanced approach is the correct one. Start with spending goals based on the priorities of the American people and then set tax policy to realize adequate revenue. The Hoover economists' advocacy of paying for large tax cuts with entitlement reductions would take the United States in the wrong direction.

QUESTIONS FOR THE RECORD FOR DR. HOLTZ-EAKIN SUBMITTED BY REPRESENTATIVE CAROLYN B. MALONEY

1) Four years ago, the consensus estimate at the Federal Reserve of the NAIRU was 5.4 percent. This should have meant that a further drop in the unemployment rate likely would put upward pressure on wages. In response, the Federal Reserve in theory should have soon raised interest rates. What would have happened if the Federal Reserve raised interest rates at that time? How should that experience inform our understanding of the NAIRU, wages and interest rates now?

Prematurely normalizing monetary policy would have slowed the pace of growth, diminished employment growth, and harmed wage growth. At present, there appears to be considerable uncertainty regarding the point at which the labor market will tighten. Job creation in the payroll survey has averaged just over 200,000 per month so far this year, much above what one would have expected in a full employment economy. The Fed should be vigilant to evidence of an uptick in supply-chain price pressures (especially for goods; services inflation is already at the Fed target), but not rely on the unemployment rate as the primary indicator of the stance of monetary policy.

2) In your testimony, you note that in its April Budget and Economic Outlook, the Congressional Budget Office projects that economic growth will average 1.9 percent over the period 2018–2028. Yet the 2018 Economic Report of the President estimates that it will be 3.0 percent over that period—a very large difference. Which estimate do you think is more realistic?

I believe that CBO number is a bit low. Because it relies on current law, it cannot anticipate future actions that will likely diminish the crowding out and thus magnify the impact of the business tax reforms. The Economic Report of the President has a different bias. It assumes that every one of the President's proposals is implemented in a timely fashion and works exactly as planned. That is also unlikely to happen and leads to an upward bias in the growth projections. I anticipate that reality will be in between.

QUESTIONS FOR THE RECORD FOR DR. HOLTZ-EAKIN SUBMITTED BY VICE CHAIRMAN LEE

How long do you think we have before our luck runs out—that is, when this current period of economic growth and viability will be overshadowed by the grim fiscal situation we find ourselves in?

If left literally unchanged, I cannot imagine completing the 10-year budget window without detrimental impacts. However, I would very much prefer not to run the experiment and see if I am right or wrong. It is always better to move earlier and phase-in large changes and I would prefer that strategy.

In my mind, a conversation about "unleashing America's economic potential" cannot happen without discussing how we are preparing the next generation of workers—teachers, doctors, scientists, welders, manufacturers, and so on. This conversation must include serious reforms to higher edu-

cation that would provide for more access to degrees and certifications that may or may not be driven by a traditional four-year institution. Innovation in this arena is critical, and we should be thinking about how we are—or how we are not—empowering states, local institutions, and private entities in finding these solutions. Do you think higher education reform plays a role in the ability of future generations to sustain our current pattern of strong economic growth? Could you expand on your recommendations for higher education reform?

Education and the skills of the labor force are central to the future of the U.S. economy. Broadly, I believe that better performance in higher education begins with improving the K–12 education system. As I noted (here) progress has stalled on this front. Students that arrive to college needing any remedial education are far more likely to graduate slower, not graduate, and suffer from student loan debt. This can be avoided.

Higher education itself needs to compete on the basis of price and quality. The reforms closest to the Federal Government are student loans and grants. Currently these are focused on paying for students to attend college. Instead, they should be tied to outcomes (staying on schedule, graduating, being employed, etc.) and not merely showing up. These outcomes can be measured independent of specific institutions (e.g., 4-year public university), allowing for new entry, innovation, and competition.

QUESTIONS FOR THE RECORD FOR DR. MOUTRAY SUBMITTED BY VICE CHAIRMAN LEE

Are you concerned with the job losses that will likely result for a number of manufacturers in other industries besides steel and aluminum as a result of the Sec. 232 tariffs implemented by the president? Would you advocate for a congressional approval process for the imposition of such measures?

The NAM has been actively engaged with our members on this issue. At this point, there is still a lot of uncertainty given that several countries have been temporarily suspended while negotiations are ongoing and companies are now seeking product exclusions for products not made or available in the United States or needed for national security reasons. Different parts of the manufacturing sector are reporting differential effects on their production and competitiveness.

The NAM is working with the Administration and others throughout the U.S. and international business communities to address the underlying issues that have given rise to distortions in these markets, most notably subsidies and distortive practices out of China that are impacting several other industries as well, from semiconductors to cement and fertilizers.

Under the U.S. Constitution, Congress retains the authority to "regulate trade with foreign nations" but has chosen to delegate certain authorities to the executive branch, including through section 232 of the Trade Expansion Act of 1962, as amended. Manufacturers strongly support a strong congressional-executive partnership on trade issues that will eliminate foreign barriers and market-distorting practices, raise standards to improve U.S. competitiveness, and hold all countries accountable in a rules-based trade system.

In my mind, a conversation about "unleashing America's economic potential" cannot happen without discussing how we are preparing the next generation of workers—teachers, doctors, scientists, welders, manufacturers, and so on. This conversation must include serious reforms to higher education that would provide for more access to degrees and certifications that may or may not be driven by a traditional four-year institution. Innovation in this arena is critical, and we should be thinking about how we are—or how we are not—empowering states, local institutions, and private entities in finding these solutions. What types of continuing education does the manufacturing sector pursue? Do you have any ideas for specific types of programs, outside the traditional four-year model, that might be useful for continued development in the manufacturing industry? If there was more flexibility from the Federal Government on what educational opportunities Federal student loan dollars could support, do you think your industry would explore these opportunities?

Manufacturers have been outspoken and persistent in efforts to gain new tools and new opportunities to address the skills gap. It is common for the manufacturing sector to promote a wide range of continuing education options for its employees. These include customized training programs designed to meet specific company needs, certification programs for specialty occupations, and tuition reimbursement

programs common in many other industries. Manufacturers are hiring and promoting based on skills and competencies. That trend will only accelerate in the new economy. Increasingly, we are also seeing manufacturers use earn-and-learn models such as internships, apprenticeships, and cooperative work-study programs to attract and retain employees.

As I noted in my testimony, manufacturers cite the inability to attract and retain a quality workforce as their top concern in the latest NAM survey. This means that manufacturing leaders need to get creative to proactively address the workforce shortage facing the industry.

The Manufacturing Institute, which is the non-profit affiliate of the NAM, continues to work with industry leaders to address these workforce challenges. This includes initiatives designed to change perceptions about the sector, including youth programs and Manufacturing Day promotions, and programs to encourage more women and military veterans to pursue a career in manufacturing. On the latter, the Institute has launched a full-time career skills program called Heroes MAKE America, with its inaugural class just graduating at Fort Riley in Kansas, and with additional installations beginning at Fort Hood in Texas starting this summer.

Regarding the flexibility of student loan dollars, yes, the manufacturing industry would support these efforts. The Manufacturing Institute recently published a paper titled Quality Pathways: Employer Leadership in Earn and Learn Opportunities that discussed how to expand the role of companies in education and assure quality outcomes for those programs. If earn and learn models can demonstrate results as good as, if not better than, traditional postsecondary pathways, then they should have access to the Federal resources that support traditional postsecondary education options.

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