Testimony

Addressing the Growth Challenge

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

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

Economic Growth: Past and Present[1]

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

Figure 1: Disappointing Economic Growth

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

Figure 2: CBO January Baseline

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Even more troubling than the recent past is the outlook. The Congressional Budget Office (CBO) projects U.S.

economic growth to average only 2.1 percent over the next decade – consistent with the tepid recovery seen since the third quarter of 2009. This rate of growth is below that needed to improve the standard of living at the pace typically enjoyed in post-war America.

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

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

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

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

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

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

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

Any rapidly improving average standard of living should be shared broadly. Despite assertions to the contrary, that has been the historic norm in the U.S.[2] More recently, there have been numerous assertions that the labor market is "broken" and that there is a disconnect between labor productivity and compensation that has only grown over time. This purported disparity has been used to justify an ever-growing menu of policies that includes a higher minimum wage, increased unionization, and other similar labor policies. Fortunately for workers, this disconnect is a myth. Calculated correctly, compensation has tracked worker productivity, belying the notion that broad economic growth is not broadly shared.[3]

Economic Growth and the Federal Budget

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

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

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

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

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

Despite the nation's significant budgetary challenges, even incrementally higher economic growth can ameliorate the fiscal outlook by increasing taxable income and suppressing reliance on the social safety net. According to the CBO, a persistent 0.1 percentage point increase in the real growth rate translates into about $300 billion in budget savings.[4] A robust pro-growth agenda could realize multiples of this "rule of thumb" in deficit reduction.

A Pro-Growth Policy Agenda

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

Trade Agreements

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

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

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

Tax Reform

The U.S. tax code is broadly viewed as broken and in need of repair, and for good reason – it hasn't been overhauled in 30 years. Whereas the administration would instead make the tax system worse – adding higher rates and new taxes, including on the middle class – the Committee should pursue a fundamental overhaul of the nation's tax system.[11] A sound reform of the U.S. tax code is an essential element of any pro-growth strategy, and could substantially increase trend economic growth, boosting the economy and tax revenue.[12]

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

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

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

Entitlement Reform

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

Last July, the Trustees of the nation's major safety-net programs raised the annual alarm that America's entitlement state is going bankrupt – driving up deficits now and leaving America's seniors vulnerable to severe benefit cuts in the future.[16] Controlling spending is more efficient than tax increases for addressing debt challenges – sensible entitlement reform therefore can be a part a pro-growth agenda, while assuring the financing of these programs for future generation.

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

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

Impact on Businesses

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

Employer Mandate and the 30-hour Work Week

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

Along with the potential for decreases in the number of full-time employees (and therefore wages), the ACA not only punishes employers for not providing coverage, but also for offering health insurance plans that are not up to ACA standard benefit requirements. The House has already moved to increase the workweek provision to 40 hours per week, and a complete repeal of the employer mandate should be pursued, as it would lift some of the pressures on the economy.

Poorly Designed Taxes

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

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

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

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

Conclusion

The United States' recent disappointing economic past threatens to become its future without a commitment to a pro-growth policy agenda. Within this Committee's purview are policies that could open markets abroad, improve a broken tax code, and undo the damage done to the health care sector and the economy by the ACA. These policy prescriptions should bolster economic growth, which will strengthen the nation's precarious finances. More importantly, faster economic growth is essential to improving the standard of living for the next generation, a basic obligation that has always been fulfilled in the past.

[1] This section is drawn from https://www.uschamberfoundation.org/sites/default/files/The%20Growth%20Imperative.pdf