



Statement before the United States Senate Committee on the Budget
On "The Economy and Private Sector Growth"

Economic Growth

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May 3, 2017

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Chairman Enzi, Senator Sanders, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the economy and private-sector growth. Few issues are as important to the future of the United States. It is an honor.

ECONOMIC GROWTH IS CRITICAL

A growing private-sector economy is central to the health of society. Economic growth drives increases in living standards and quality of life. This is perhaps most easy to see over long periods of time. Compare life two-hundred years ago with life today. Economic growth facilitated dramatic reductions in child mortality rates and poverty rates, increased access to education and medical care, increased lifespans, and the amenities of the modern world we enjoy today.¹

It is tempting to say that at this point the nation is rich enough — the economy is large enough — and that we need to worry more about redistributing wealth and income than creating them. But imagine if our forefathers in 1817 had said the same. We owe our posterity in 2217 the same as we received from our forefathers — just as we owe our children and grandchildren, and ourselves.

Of course, some level of redistribution is clearly desirable. Economic growth allows for redistribution to be more palatable by increasing the resources that can be redistributed. More generally, economic growth is important because it mitigates distributional conflict. Without growth, the only way for me to do better is for you to do worse. With growth, I can do better and you can stay the same. Ideally, of course, growth allows you and me both to do better.

The growth rate of the economy has been disappointing of late. Since the year 2001, real annual GDP has grown at an average rate of 1.8 percent. In the fifty years prior, real annual GDP

¹ For examples see: Robert Gordon, [*The Rise and Fall of American Growth: The U. S. Standard of Living Since the Civil War*](#), Princeton University Press, 2016.

grew at an average rate of 3.6 percent — double the average this century.² The rate of economic growth is widely expected to remain significantly lower over the next ten years than in the decades near the end of the twentieth century.

INCREASING THE ECONOMY’S GROWTH RATE

Economists model economic output as a function of economic inputs. The growth rate of output, therefore, is determined by the growth rates of inputs: labor, capital, and technology. Policy can affect the growth rate. For example, policy can encourage savings and investment by switching from a tax system that taxes income to a system that taxes consumption.³ Economic theory predicts that the larger capital stock associated with a system of consumption taxation (relative to income taxation) will make workers more productive, and increase their wages. And during the transition to a consumption base, the economic growth rate will increase.⁴ In addition, rising federal debt is a threat to long-run economic growth, in part through reducing private investment.⁵ The Congress should take steps to reduce projected debt, including reforming middle-class entitlement programs.

Like tax and budget policy, labor market policy — employment policy — can increase the economy’s growth rate. A specific goal of labor market policy should be to increase the rate at which adults participate in the workforce, which would increase the economy’s growth rate, among other benefits.

² Author’s calculations based on Bureau of Economic Analysis data.

³ For more information about consumption taxes, see: Alan D. Viard, “[Fundamental Tax Reform: A Comparison of Three Options](#),” *The Economics of Tax Policy*, Alan J. Auerbach and Kent Smetters editors, Oxford University Press, 2017. Robert Carroll, Alan D. Viard, and Scott Ganz, “[The X Tax: The Progressive Consumption Tax America Needs?](#)” *AEI Tax Policy Outlook*, no. 4, December 2008. Robert Carroll and Alan D. Viard, *Progressive Consumption Taxation: The X Tax Revisited*, AEI Press, 2012.

⁴ For example, see: Alan J. Auerbach, Lawrence J. Kotlikoff, and Jonathan Skinner, “[The Efficiency Gains from Dynamic Tax Reform](#),” *International Economic Review*, vol. 24, no. 1, February 1983.

⁵ Congressional Budget Office, “[The 2017 Long-Term Budget Outlook](#),” 30 March 2017.

The workforce participation rate for men ages twenty-five to fifty-four — males who are generally speaking too old to be enrolled in school and too young to be retired — has been falling for the past six decades.⁶ This trend has historically not received much attention due in part to the fact that the overall workforce participation rate — the rate for men and women combined — has been rising. But since 2000, the overall workforce participation rate has been declining.⁷ And the overall workforce participation rate for women has been declining since 2000 as well.

It is reasonable to argue that labor market regulation is suppressing the workforce participation rate. Occupational licensing requirements have, in some cases, ceased to serve as reasonable precautions to protect the public's health and safety, and to encourage quality service, and have instead become barriers to entry for aspiring workers. For example, according to the Institute for Justice, on average an interior decorator requires 2,190 days of training for licensure, whereas an emergency medical technician requires thirty-three days of training.⁸ Congress can provide incentives for the states to reduce unnecessary licensing requirements.

Economists debate the employment effects of minimum wage increases, but in my view the balance of the evidence suggests that by regulating wages Congress is suppressing

⁶ Prime-age male labor force participation peaked in 1954 at 97.9 percent. The decline in prime-age male workforce participation has been the subject of recent interest. For examples, see: White House Council of Economic Advisers, "[The long-term decline in prime-age male labor force participation](#)," June 2016. Nicholas Eberstadt, *Men Without Work: America's Invisible Crisis*, Templeton Press, September 2016. Michael R. Strain, "[Getting Back to Work](#)," Conservative Reform Network, 2015. Alan Krueger, "[Where Have All the Workers Gone?](#)" presented at Federal Reserve Bank of Boston, October 2016.

⁷ Note that here I am referring to the labor force participation rate of Americans aged 16 and older, which is the standard definition.

⁸ Dick M. Carpenter II, Lisa Knepper, Angela C. Erickson, and John K. Ross, "[License to Work](#)," Institute for Justice, May 2012.

employment.⁹ And raising the federal minimum wage to twelve dollars per hour, as has been discussed, would, in my view, have a non-trivial effect on employment.

Beyond regulation, current labor market policies should be reformed. Two important policies in need of reform are the Social Security Disability Insurance (SSDI) program and the Unemployment Insurance (UI) program. Between 1989 and 2009, the share of working-age adults receiving SSDI benefits doubled¹⁰, at the same time that workplace safety increased, service-sector employment increased, and the quality of healthcare increased. A just society makes provision for disabled workers, but it seems clear that the structure of SSDI is unnecessarily discouraging workforce participation, and has become for some workers a permanent UI program. SSDI's structure made sense for a manufacturing economy in which disability often resulted from physical accidents. But in a services economy, and with the definition of disability broadened to include health conditions that are harder to diagnose, SSDI is likely (unintentionally) keeping many recipients out of the workforce who could be working and who would like to be working.

UI could also be reformed to increase workforce participation. The long-term unemployed — workers without a job but who have been actively searching for six months or longer — who live in local labor markets characterized by high unemployment and low employment could be offered financial assistance to move to a stronger local labor market. This

⁹ For examples of recent minimum wage research, see: Arindrajit Dube, T. William Lester and Michael Reich 2010, "[Minimum Wage Effects Across State Borders: Estimates Using Contiguous Counties](#)," *Review of Economics and Statistics*, vol. 92, no. 4, November 2010. Jonathan Meer and Jeremy West, "[Effects of the Minimum Wage on Employment Dynamics](#)," *Journal of Human Resources*, vol. 51, no. 2, spring 2016. Jeffrey Clemens and Michael R. Strain, "[Estimating the Employment Effects of Recent Minimum Wage Changes: Early Evidence, an Interpretative Framework, and a Pre-Commitment to Future Analysis](#)," *NBER Working Papers*, no. 23084, January 2017. For a review of the literature, see: David Neumark and William L. Wascher, "[Minimum Wages and Employment](#)," *Foundations and Trends in Microeconomics*, vol. 3, no. 1—2, 2007. I provide my perspective here: Michael R. Strain, "[More than the Minimum Wage](#)," *National Review*, 11 December 2013.

¹⁰ David H. Autor and Mark Duggan, "[Supporting Work: A Proposal for Modernizing the U.S. Disability Insurance System](#)," Center for American Progress and The Hamilton Project, December 2010.

would likely lead to shorter unemployment spells, and to fewer workers leaving the workforce altogether.¹¹ Other safety net programs should be evaluated to see whether pro-work reforms could help beneficiaries get back to work.

Policy should increase workforce participation by increasing the number of highly skilled immigrants allowed to live and work legally in the United States. In addition to increasing the growth rate of the economy through increasing the growth rate of the labor force, immigrants start more businesses than native-born workers,¹² and businesses in “STEM” industries are disproportionately likely to be founded by an immigrant.¹³ New businesses create jobs, strengthening the economy. And occasionally we hit the jackpot and an immigrant starts a Google.¹⁴

Public policy should increase workforce participation through increasing the generosity of the Earned Income Tax Credit (EITC). The EITC is an earnings subsidy. Because it supplements earnings, it only goes to households that work. Because eligibility is conditioned on household income, the subsidy only goes to low-income households. Previous expansions of the EITC have been shown to significantly increase the workforce participation rates of targeted populations.¹⁵

¹¹ I discuss this policy reform, among others, here: Michael R. Strain, “[A Jobs Agenda for the Right](#),” *National Affairs*, no. 18, winter 2014.

¹² Immigrants are more than twice as likely as those born in America to start a business; see: Robert Fairlie. “[Open for Business: How Immigrants Are Driving Small Business Creation in the United States](#),” The Partnership for a New American Economy, August 2012.

¹³ One fourth of all technology and engineering companies had at least one immigrant cofounder between 2006 and 2012; see: “[The Economic Case for Welcoming Immigrant Entrepreneurs](#),” *Entrepreneurship Digest*, Ewing Marion Kauffman Foundation, September 2015.

¹⁴ I discuss a policy reform for high-skilled immigrants here: Michael R. Strain, “[Stapling Green Cards to Diplomas: Time to Make This Cliché a Law](#),” *The Atlantic*, 21 June 2012.

¹⁵ For a review of these studies, see: Hilary Hoynes and Jesse Rothstein, “[Tax Policy Toward Low-Income Families](#),” *The Economics of Tax Policy*, Alan J. Auerbach and Kent Smetters editors, Oxford University Press, 2017.

Expanding the EITC again would, I believe, have similar effects. The subsidy for childless workers is an obvious candidate for expansion. Currently, the maximum subsidy for these workers is around five-hundred dollars per year.¹⁶ This is inadequate, and expanding it would increase workforce participation among this population.

In addition to increasing the workforce participation rate, public policy should attempt to increase the productivity of the workforce through increasing the skills of workers. Increasing productivity would increase the short-run growth rate, and is the key factor behind long-term economic growth. Work-based learning offers a promising path towards increasing skills. Such programs combine on-the-job training with classroom learning, often at a community college.¹⁷ In the case of apprenticeships, participating firms post vacancies and hire an apprentice only if the hire makes business sense. In this way, the market is determining where workers get trained, and the content of on-the-job training. Having the market determine the content of training is much superior to traditional, government-run training programs. Apprenticeships and other forms of work-based learning are showing promise, and should be expanded.

And, of course, in addition to postsecondary education, primary and secondary education need to be reformed to better achieve their mandate of creating a workforce with the basic skills required by the twenty-first century economy.

In addition, international trade allows for specialization here at home, which increases productivity. The United States should maintain a posture of openness towards trading with other

¹⁶ Internal Revenue Service, [2017 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates](#), accessed 25 April 2017.

¹⁷ For more information on work-based learning, see: Robert I. Lerman, "[Expanding Apprenticeship Opportunities in the United States](#)," The Hamilton Project, June 2014. Harry Holzer, "[Higher Education and Workforce Policy: Creating More Skilled Workers \(and Jobs for Them to Fill\)](#)," Economic Studies, Brookings Institution, April 2015.

nations, and should not embrace protectionist policies. The Congress has a critical role to play in this effort.

CONCLUSION: THE IMPORTANCE OF INNOVATION

My remarks have focused mostly on economic growth over the short and medium term, the period that is most immediate and most amenable to policy interventions. Over these time horizons, increasing the growth rates of the labor force and capital investment are extremely important, as is improving the skills of the workforce. But over long periods of time, nothing is more important to economic growth than innovation, than letting loose the creative power of individuals. New ideas, new inventions, new technologies — new things that rose along with a new culture around work, equality, and dignity — are what created the world we live in today. They took, and are taking, billions from poverty to wealth, from illness to health, from short to long lives, from ignorance to educated. Government should have in mind the importance of sustaining a culture that allows for creativity and energy. Public policy should not stifle human potential, the growth that comes with it, and the betterment that it creates.