
# Take Two: The President's Proposal to Stimulate the Economy and Create Jobs

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Mr. Chairman, members of the Committee, I am honored to be invited to testify before you today on the subject of President Obama's newest proposals to create jobs. I am a senior fellow at the Manhattan Institute. From 2003 until April 2005 I was chief economist at the U.S. Department of Labor. From 2001 until 2002 I served at the Council of Economic Advisers as chief of staff. I have also been a senior fellow at the Hudson Institute and a resident fellow at the American Enterprise Institute. I have served as Deputy Executive Secretary of the Domestic Policy Council under President George H.W. Bush and as an economist on the staff of President Reagan's Council of Economic Advisers.

On September 12 President Obama sent his American Jobs Act to Congress. He called on Congress to pass a bill with additional spending of $447 billion, with an extension of payroll tax cuts and unemployment benefits, more infrastructure spending, and additional aid for state and local governments.

Temporary tax reductions have limited effect in stimulating investment and economic growth. Since consumers and businesses know that the tax cuts are temporary, they do not make permanent changes in their behavior. This finding won Professor Milton Friedman the Nobel Prize in economics. In order to inspire confidence and change behavior, tax cuts have to be permanent.

Similar solutions to unemployment were tried in 2009, as part of the $825 billion "stimulus." The "stimulus" failed to spur GDP growth significantly and create jobs, despite record low interest rates and monetary stimulus from the Federal Reserve. If an $825 billion stimulus—plus cash for clunkers, auto bailouts, and mortgage forgiveness programs—resulted in an annualized GDP growth rate of only one percent two years after the end of the recovery, and succeeded only in raising the January 2009 unemployment rate of 7.6 percent, why would a package that is half the size reduce an unemployment rate that is now 9.1 percent?

In January 2009, the long term unemployed, those out of work for 27 weeks or more, were 22 percent of the total unemployed. Now they represent 43 percent of the unemployed. In January 2009, 69 percent of the population was employed. Now, the percentage is 58 percent, the lowest level since 1983. Back in January 2009 the African American teen unemployment rate was 36 percent. Now, it's 46 percent. It is much harder to get these individuals back in the labor force.

Those who believe that the 2009 stimulus simply was not enough—and, for the record, I am not among them—should admit that if $1 trillion did not work in 2009, then $447 billion is unlikely to solve an even larger problem in 2011.

"Shovel-ready" infrastructure projects that weren't, grants to the poor and the unemployed, funds for unionized public sector workers…we saw this in 2009.

Stanford economics professor Michael Boskin calculates that each job created or saved by the stimulus cost $280,000—five times as much as median wage.

Since the stimulus passed, wrote Professor Boskin in *The Wall Street Journal* on September 8, America has seen the first downgrade of American sovereign debt in history, the highest level of Federal spending since World War II, the lowest percent of Americans employed since 1983, and the highest level of long-term unemployment since the 1930s.

What is needed is a different approach—lower taxes, less regulation, and cuts in entitlement programs in the decades ahead by reforming Social Security, Medicare, and other transfer programs.

Former Massachusetts Governor Mitt Romney has published a detailed economic plan that would cut the corporate tax rate, encourage domestic energy production, devolve federal government training programs and funding to states, and cut non-security discretionary spending by 5 percent.

Tougher regulations lead employers to locate elsewhere. Friendlier regulations draw them back home.

Mr. Obama acknowledged this when, on January 18, 2011, he issued Executive Order 13563, entitled Improving Regulation and Regulatory Review.

Each agency is supposed to make a plan to "periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives."

The most effective part of Mr. Obama's job creation plan likely came last week, when he instructed the Environmental Protection Agency to refrain from adopting stricter standards on ozone.

The new rule would have tightened the requirements for ozone allowed in the air from the current standard of 84 parts per billion to 60 to 70 parts per billion.

The 60 parts per billion standard would have put 85 percent of American counties with ozone monitors out of attainment. Counties would have to pursue compliance by restricting industrial activity, such as manufacturing and energy production and infrastructure construction, potentially costing $20 billion to $90 billion a year, according to EPA.

Mr. Obama's action amounted to an admission that imposing new, more costly regulatory requirements on business may conflict with hiring additional workers, most Americans' primary policy goal.

Many regulations are unneeded. Our air and water are getting cleaner as new equipment replaces old. And regulations make America a less attractive place for companies to locate and create jobs.

Furthermore, the links between improved air quality and health are unclear. At the same time as air quality has been improving, the incidence of asthma, a disease commonly associated with polluted air, has been increasing. Between 1980 and 2001, as measured air quality was improving, the prevalence of asthma tripled, according to the Centers for Disease Control.

While Mr. Obama knows that burdensome regulations crimp job creation, his agencies continue to interfere with private sector job creation.

**EPA**

EPA leads the agencies in regulations, with 308 rules pending on its docket. They are published in the EPA section of the government's regulatory agenda, at www.reginfo.gov.

The list includes rules in all stages of development, such as "Prerule," "Proposed Rule," "Final rule," and "Long Term Action." Not counted in the rules under development are an additional three dozen listed as "Completed Action."

House Majority Leader Eric Cantor included seven proposed EPA regulations in his list of 10 job-killing regulations last month. One of them was the ozone regulation. Others had to do with utilities, boilers, cement, coal ash, farm dust, and greenhouse gases.

For example, EPA's new boiler rules would make electricity generation far more complicated and expensive even as Mr. Obama wants to put more electric cars on the road. Power plants and boilers would be required to limit their emissions of "heavy metals," including mercury, arsenic, chromium, and nickel, and of acid gases, such as hydrogen chloride and hydrogen fluoride.

These rules, like others, require "maximum achievable control technology," meaning that plants have to use the most stringent methods available to remove heavy metals from the air, regardless of costs and benefits. Removing such particulates from the air that we breathe seems desirable, but the regulation does not take adequate account of cost.

But why stop at one regulation or seven? Why not put a hold on more regulations? They create a climate of uncertainty, damaging economic growth and employment, and inhibiting employers and investors.

It is clear that major rules such as clean-air transport, utilities, and boilers reduce hiring. It's not so obvious that, in addition, hundreds of obscure rules also affect employment.

Take Rule 2070-AJ74, Revision to Compliance Date for Pesticide Container/Containment Rule, put out by EPA's Office of Chemical Safety and Pollution Prevention, which extends the date for updating pesticide container labels.

The rule came about, as the EPA states, because "while there has been significant progress in the number of pesticide labels that have been updated with the container management statements required by the container-containment regulations, EPA has recently become aware that there are still a substantial number of products whose labels must be submitted to EPA, reviewed and approved by EPA, and reviewed and approved by the States."

That means that there are manufacturers whose labels haven't been processed by EPA or the states. A regulatory bottleneck. Somewhere, a producer may be thinking that he won't be able to sell his pesticides because a government agency hasn't approved a label he submitted. He has to work out how to change the label so it passes inspection. Some producers will choose others lines of business.

Or, consider Rule 2040-AF20, Revised Regulations for Concentrated Animal Feeding Operations (CAFOs) in the Chesapeake Bay Watershed, issued by EPA's Office of Water. This rule is not classified as major, and the legal authority is "not yet determined." Its priority is listed as "substantive, nonsignificant," even though these terms seem to contradict each other.

Still, it's going to make life harder for farmers, because it will potentially tell them how they should feed their cattle. It will expand federal jurisdiction over the feeding of cattle and disposal of cattle manure, both in the Chesapeake Bay area and nationally.

This means that EPA will tell farmers throughout the United States what they should be feeding their cattle and what to do with cattle droppings. Not only do farmers have to cope with the July drought and the August flooding, but also what EPA tells them to do with food and manure.

**NLRB**

Then, take the National Labor Relations Board. The acting general counsel of the NLRB, Lafe Solomon, wants to stop the Boeing Company, which has a backlog of over 800 Dreamliner aircraft on order, from using its new aircraft manufacturing plant in South Carolina to build Dreamliners.

Mr. Solomon has charged that Boeing's decision to build a new plant at North Charleston, South Carolina, to expand production of its Dreamliner 787, was made in retaliation for strikes at its Everett, Washington plant in 2005 and 2008, even though Boeing has added workers in Washington State since the strikes.

Mr. Solomon's charge was brought in response to a complaint from the International Association of Machinists and Aerospace Workers, which represents Boeing employees in Washington State.

The NLRB's action is sending a job-chilling signal to foreign and domestic companies which might want to locate plants in America. If Boeing had built its new plant in China, the NLRB would lack any authority over it.

In addition, as if employers weren't burdened with enough paperwork, the Board will now require employers to put up 11" by 17" posters informing workers of their right to unionize. Whether the Board has the authority in law to require employers to put up posters is in dispute. Sooner or later, this issue may be tested in the courts.

Requiring posters won't benefit the 14 million unemployed Americans, but it is yet another message to employers that the administration regards them with hostility and suspicion. Other countries do not require these posters and welcome American businesses to hire their workers.

In a lack of symmetry, the Board does not require employers to inform their workers that they have a right to ask for a decertification vote to kick out a union. Nor that workers have a right to a refund of the portion of their dues used for political contributions.

The posters don't convey what workers may lose from unionizing, such as the ability to earn individual merit raises. They don't point out that collective bargaining can result in lower pay and job loss for some workers.

The required poster size, 11 X 17 inches, is larger than is required for notices for minimum wage, employee polygraph protection, family medical leave, equal employment opportunity and other employee rights guaranteed by Congress.

If 20 percent or more employees are most comfortable speaking a language other than English, an additional poster in translation must go up. That's two posters.

If the employer fails to display the poster, the Board can declare the employer guilty of an "unfair labor practice." There's no fine, but unfair labor practices can be held against an employer in the case of a dispute with the union or a drive to organize a workplace with no union relationship.

The requirement applies to all private workplaces, no matter how few employees. However, retailers with less than $500,000 in gross sales are exempt, as are nonretail businesses with less than $50,000 in out of state sales or purchases.

It is unclear that the National Labor Relations Board has the authority to require employers to display what one must regard as a union-organizing poster.

According to John Raudabaugh, a Board member from 1990 to 1993 and now an attorney with Nixon Peabody, the Board lacks authority to require the poster under the 1935 National Labor Relations Act.

Mr. Raudabaugh explained that "every federal statute in the field of labor and employment law, such as the Fair Labor Standards Act, the Railway Labor Act, and the Equal Employment Opportunity Act, specifically mentions the right of the relevant agency to issue posting of notices to employees. The National Labor Relations Act is silent on the notice to post."

The Board lists ten other laws that require posting and concluded in its December 2010 Notice of Proposed Rulemaking that "The NLRA is almost unique among major Federal labor laws in not including an express statutory provision requiring employers routinely to post notices at their workplaces informing employees of their statutory rights." This, curiously, seems to be an admission by the Board that it lacks statutory authority.

The Railway Labor Act was amended in 1934, one year before NLRA passed, and included specific mention of a notice to employees. One must conclude that if Congress had wanted non-railroad employers to post notices, it would have specified this in the 1935 Act.

**Labor Department**

Space does not permit detailed discussion of all the rules the Labor Department wishes to impose on employers.

Consider the proposed Labor Department rule from the Office of Federal Contract Compliance Programs entitled "Affirmative Action and Nondiscrimination Obligations of Contractors and Subcontractors Regarding Protected Veterans." It takes up 67 single-spaced pages in the Federal Register. The comment period closed on July 11, and the Department is reviewing comments in order to publish a final rule notice by December.

About 26 million workers are employed by federal contractors, according to the Labor Department's Web site, almost one-fifth of the economy's 139 million employed workers. The more time and money an employer must devote to regulatory compliance, the less likely the employer is to hire new hands. Like it or not, that's a fact of life.

The new rule would require procedures for federal contractors and subcontractors that would be time-consuming and costly.

- Contractors would have to list job openings for veterans with an "appropriate employment service delivery system." This means that the Office of Federal Contract Compliance has to approve of the employment agencies where job vacancies are posted.

- Contractors would have to maintain annual records of referrals of all job candidates, referrals of veterans, and the ratio of veteran referrals to all referrals. This would be substantial paperwork burden. If employers did not get enough veteran referrals, they could get dropped as federal contractors.

- Employers would have to print notices of employee rights and contractor obligations in Braille and large print for workers who are visually impaired. If they are visually impaired, additional accommodations would have to be made.

- Contractors' affirmative action programs for veterans would have to be reviewed and updated annually, as well as mental and physical requirements for job descriptions.

- Contractors would have to engage in outreach and recruitment efforts in order to make sure that veterans hear about the openings and apply.

- Employers would have to conduct mandatory all-employee and management meetings to discuss their affirmative action policies and make sure everyone understands them. Currently, such notices must be posted on employee bulletin boards in full view, often in cafeterias or outside human resources offices.

Laws requiring affirmative action for veterans have been in place since 1974. The Labor Department writes that "the proposed regulations would strengthen these affirmative action provisions, detailing specific actions a contractor must take to satisfy its obligations."

Do veterans need yet more regulation meant to discourage discrimination against them in hiring? Is such discrimination common? The August unemployment rate for veterans, at 7.7 percent, is lower than the overall unemployment rate of 9.1 percent, as calculated by the Labor Department.

Even the American Legion, a congressionally-chartered organization to help veterans, thought some requirements too burdensome. In published comments, the Legion wrote, "The American Legion believes that [job listing regulations] could place an undue burden on contractors, including many veteran-owned small businesses and service-disabled-veteran-owned small businesses. Rather than placing such an undue burden on these contractors - the government should make it as easy as possible for companies to post their job listings with any employment service."

Some businesses, especially small ones, simply cannot survive with these rules. Those that can survive will have higher costs and be less inclined to hire employees. The ironic result: in the name of helping veterans, the Labor Department's policies will mean fewer jobs for everyone, including veterans.

Then, consider the Labor Department's rules regarding coal. EPA regulations describe above would discourage coal from being burned in power plants, but it can be mined and exported. Coal exports are significant, 76 million tons in 2010, 23 percent higher than in 2009.

Proposed Labor Department regulations, if made final, would discourage coal from being produced at all. Over 30 new regulations for coal are on the Labor Department's regulatory agenda.

These regulations discourage coal production, causing unemployment of miners and others in mining communities. Moreover, by making the use of coal more expensive, the government discourages energy-intensive industries, such as manufacturing, from locating in the United States, in effect, encouraging them to flee abroad.

Another proposed Labor Department regulation is affirmative action for women on construction sites. Discrimination is already illegal in the construction industry. In practice, this rule would require construction companies to employ less-qualified women.

With the construction industry still sick from the recession, and women's unemployment rates in August almost a full percentage point lower than men's (8 percent for women, compared with 8.9 percent for men), this is not the time to force construction companies to employ women.

**Importing Entrepreneurs**

My testimony has focused on costless ways to increase employment. It would not be complete without a discussion of how additional immigration could spur job creation.

The Ewing Marion Kauffman Foundation in Kansas City has published extensive studies on importing job creators from abroad to create start-ups and hire workers, and attract tourists to give more business to our stores, beaches, restaurants, and wilderness areas.

Start-ups lead to innovation, which leads to economic growth. Think Facebook, with its friends and captivation of an entire generation. Or think of Apple, a start-up just a generation ago. In the second quarter of 2011, all 9.3 million iPads produced were sold. People are buying them for personal use, companies are buying them for employees. And this is in an economy with a 1.9 percent growth rate and 9 percent plus unemployment.

If we had another two dozen new Apples or Facebooks every year making similarly attractive products, our economic growth and our employment would really take off. That's because data show that new companies, those in their first few years of existence, hire a lot of workers on net. That means some companies start and fail, but others make up for it, and more.

Many people don't understand how immigrants could solve our jobs problem. "Why give out more visas when we have a high unemployment rate?" is a typical question.

But Kauffman data show that immigrants found new companies in America at greater rates than do native-born Americans. So if we allowed more immigrants to enter, and gave green cards to those who created jobs, employment would rise.

Consider Sergei Brin's Google, Andrew Grove's Intel; Jerry Yang's Yahoo; Pierre Omidyar's eBay; and Elon Musk's PayPal, Tesla Motors, and SpaceX, to name but a few. Past founders include Alexander Graham Bell, Levi Strauss, Adolph Coors, and Henry Heinz.

Once companies are around five years old, they appear to reach a hiring equilibrium. They keep the workers they have already hired, but on average their employee expansion rate slows down and they generate no new jobs. So the best way to expand employment in an economy is to figure out how to get more new, innovative firms.

A bill sponsored by Massachusetts Democrat John Kerry and Indiana Republican Richard Lugar would set up a new class of visa called the EB-6, aimed especially at entrepreneurs.

Those who could bring in capital from abroad, or who have already generated U.S. sales, would be eligible for the visa. If they hired a certain number of non-family members, the EB-6 would transition into a green card, and they could stay forever and become citizens.

The Kerry-Lugar bill proposes about 5,000 EB-6 visas a year. The Kauffman Foundation suggests making the number unlimited, to allow as many founders as possible to have the opportunity to come to America to start companies. Those immigrants who did not hire workers would not receive green cards and would have to return to their countries.

In essence, the Kauffman plan would allow America to take a number of potential entrepreneurs on a provisionary basis, and keep the successful ones.

This visa would be especially attractive to some of the million immigrants in America who now have temporary H1-B visas, work permits obtained by employers that require workers eventually to return to their home countries. If H1-B visa holders could start companies and hire other workers, they could convert the H1-B visa to the EB-6, and then progress to the green card.

Once an H1-B visa holder was converted into an EB-6, one market for the new entrepreneur would be his former firm. Rather than selling his services to an employer, he would sell his firm's services to his former employer-and to other employers also.

Another group that could benefit from EB-6 visas would be the 60,000 foreign students who graduate with American degrees in the technical fields of science, technology, engineering, and math.

The possibility of such visas would encourage more foreign students to come here to study. Now, many do not come, because they believe that they will just have to return home when their studies are completed. Instead, they study in Canada, Britain, and Australia.

Similarly, the United States could be giving out more tourist visas, and promoting our country as the global vacation spot.

Walk into a hotel in Zurich, Switzerland, and you can find a brochure in Mandarin Chinese promoting the surrounding area. Walk into the Willard Hotel in Washington D.C. and you see nothing in Mandarin, and little in any other languages. It's no wonder that Chinese tourists go to Switzerland or Singapore.

Instead, our embassies and consulates around the globe seek to discourage visitors. They interrogate them as to their intentions and make sure they don't want to stay here. Plus, they charge substantial sums for a visa application, in the range of $200 to $300. If the visa application is rejected, the embassy keeps the fee.

**Disincentive Effects of Employer Health Care Tax**

One major disincentive to hiring is the $2,000 per worker tax in the Patient Protection and Affordable Care Act of 2010. The Act will raise the cost of employment when fully implemented in 2014. Companies with 50 or more workers will be required to offer a generous health insurance package, with no lifetime caps and no copayments for routine visits, or pay an annual tax of $2,000 for each full-time worker.

This tax raises significantly the cost of employing full-time workers, especially low-skill workers, because the tax is a higher proportion of their compensation than for high-skill workers, and employers cannot take the tax out of employee compensation packages.

Employers are not blind. They see these taxes coming, and they are adjusting their workforce accordingly. In my opinion, this is one reason that employment growth has been slower than usual during this economic "recovery."

Suppose that a firm with 49 employees does not provide health benefits. Hiring one more worker will trigger a tax of $2,000 per worker multiplied by the entire workforce, after subtracting the statutory exemption for the first 30 workers. In this case the tax would be $40,000, or $2,000 times 20 (50 minus 30). Indeed, a firm in this situation might have a strong incentive not to hire a 50$^{th}$ worker, or to pay him off the books, thereby violating the law.

In addition, if an employer offers insurance, but an employee qualifies for subsidies under the new health care exchanges because the insurance premium exceeds 9.5 percent of his income, his employer is taxed $3,000 per worker. This combination of taxes gives businesses a powerful incentive to downsize, replace full-time employees with part-timers, and contract out work to other firms or individuals. For example, a restaurant might outsource some of its food preparation versus paying employees to make it on-site.

The franchise industry will be particularly hard-hit because the new law will make it harder for small businesses with 50 or more employees to compete with those with fewer than 50 employees.

Franchisors and franchisees, who often own groups of small businesses, such as stores, restaurants, hotels, and service businesses, will be at a comparative disadvantage relative to other businesses with fewer locations and fewer employees. This will occur when a franchisor or franchisee employs 50 or more persons at several locations and finds itself competing against independent establishments with fewer than 50.

An estimated 828,000 franchise establishments in the U.S. accounted for more than $468 billion of GDP and more than 9 million jobs, based on PricewaterhouseCoopers' report of 2007 Census data. When factoring the indirect effects, these franchise businesses accounted for more than $1.2 trillion of GDP – or nearly 10 percent of total non-farm GDP. Of franchise businesses, an estimated 77 percent were franchisee-owned and 23 percent were franchisor-owned.

When the employer mandates are phased in 2014, many businesses will be motivated to reduce the number of locations and move workers from full-time to part-time status. This will reduce employment still further and curtail the country's economic growth.

Industries that have traditionally offered the greatest opportunities to entry-level workers -- leisure and hospitality, restaurants -- will be particularly hard-hit by the new law. Many of these employers do not now offer health insurance to all of their employees, and employ large percentages of entry-level workers, whose cost of hiring will increase significantly.

Such small businesses have offered an entry point to low-skill workers, who have some of the highest unemployment rates in America. Adults without high school diplomas face an unemployment rate of 14.3 percent, more than three times as high as rates for college graduates, and well above the national average of 9.1 percent. The unemployment rate for teens, another low-skill group, is 25 percent. These workers will be particularly hard-hit with the new penalties on small businesses, particularly franchise businesses.

Businesses with fewer than 50 employees will be the big winners. If they do not hire too many workers - another government-induced disincentive for hiring in this weak labor market - and stay within the 49-person limit, these firms will not have to provide health insurance and will have a cost advantage over the others. Such businesses will be able to compete advantageously against businesses with multiple locations and 50 or more employees.

When government requires firms to offer benefits, employers will generally prefer to hire part-time workers, who will not be subject to the tax. Even though the Act counts part-time workers by aggregating their hours to determine the size of a firm, part-time workers are not subject to the $2,000 tax. Hence, there will be fewer opportunities open for full-time work. Many workers who prefer to work full-time will have an even harder time finding jobs.

In August 8.8 million people were working part-time because they could not find full-time jobs. The new health care law would exacerbate this problem.

In addition to hiring more part-time workers, firms will have an added incentive to become more automated, or machinery-intensive—and employ fewer workers. Fast food restaurants could ship in more precooked food and reheat it, rather than cook it on the premises. Something analogous is already gaining momentum in industries such as DVD rental, where manual labor at retail outlets is being replaced by customer-activated DVD checkout. Supermarkets, drugstores and large-chain hardware stores also are introducing do-it-yourself customer checkout.

Some employers will be allowed to keep existing plans, a term known as "grandfathering." However, restrictions on "grandfathering" could force up to 80 percent of small businesses to drop their current health insurance plans within three years and either replace them with more expensive new plans or go without insurance altogether and pay the tax, according to estimates from the Departments of the Treasury, Labor, and Health and Human Services.

**Conclusion**

America is facing an economic crisis on a scale that our government at times seems incapable of grasping. Our mounting debts are not the result one mistake made at one time, but a series of mistakes made repeatedly over decades. We need to take a different tack, one that will encourage hiring, rather than encouraging firms to go offshore.

With zero net job gains in August, a persistently high unemployment rate, and a low rate of GDP growth, the economy could likely create more jobs through costless regulatory reform than through additional spending. I have given just a few examples. But there are many more, including the whole apparatus of

financial regulations set up by the Sarbanes-Oxley and the Dodd-Frank laws; the moratorium on deepwater drilling in the Gulf of Mexico; and our high corporate tax rates.

Thank you for giving me the opportunity to testify today. I would be glad to answer any questions you might have.