

**Testimony of Brink Lindsey
Senior Scholar in Research and Policy,
Ewing Marion Kauffman Foundation
Before the
Subcommittee on Regulatory Affairs,
Stimulus Oversight, and Government Spending,
House Committee on Oversight and Government Reform
On “Job Creation: Unleashing Entrepreneurship”
September 13, 2011**

Chairman Jones, Ranking Member Kucinich, and distinguished members of the Subcommittee, my name is Brink Lindsey and I am a senior scholar in research and policy at the Ewing Marion Kauffman Foundation. I thank you for the invitation to appear at today’s hearing and share some perspectives on the crucial challenge of reviving job creation and restoring dynamism and prosperity to the U.S. economy.

With the unemployment rate stuck above 9 percent and long-term unemployment at unprecedented levels, nobody needs to be told that the current employment situation in this country is dire. What is less well understood, though, is that the roots of our present jobs crisis go deeper than the Great Recession that began in 2008. The share of adult Americans who are employed peaked at 64.4 percent back in 2000 – 11 years ago – and has never recovered since. In 2007, before the financial crisis of 2008 and the ensuing recession, the employment-population ratio had fallen to 63 percent. It now stands at 58.2 percent, the lowest level since 1983.

For public policy to be effective in responding to this grim situation, it needs to be based on a clear understanding of where jobs come from. And on that question, research from the Kauffman Foundation leaves no doubt: new firms are the main engine of job creation in this country. Specifically, from 1977 to 2005, there were only seven years in which existing firms created more jobs than they destroyed. The bottom line is simple: without startups, there would be no net job creation in the United States.¹

Additional Kauffman Foundation research reveals that this engine of new jobs began sputtering before the Great Recession. Census data show that the number of new employer businesses created annually began falling after 2006, dropping 27 percent by 2009. Meanwhile, the average number of employees per new firm has been trending gradually downward since 1998. And the pace of job growth at new firms during their first five years has been slowing since 1994.²

¹ See Tim Kane, “The Importance of Startups in Job Creation and Job Destruction,” Kauffman Foundation Research Series: Firm Formation and Economic Growth, July 2010, http://www.kauffman.org/uploadedFiles/firm_formation_importance_of_startups.pdf.

² E.J. Reedy and Robert E. Litan, “Starting Smaller; Staying Smaller: America’s Slow Leak in Job Creation,” Kauffman Foundation Research Series: Firm Formation and Economic Growth, July 2011, http://www.kauffman.org/uploadedFiles/job_leaks_starting_smaller_study.pdf.

The timing of the deteriorating employment picture suggests that the problem is structural, not merely cyclical. And structural problems call for structural solutions. Specifically, the ultimate answer to restoring prosperity and vigorous job growth lies in policy reforms that create a more favorable environment for the creation and growth of new businesses. Barriers to entrepreneurship need to be identified and systematically dismantled.

This conclusion is further supported by my own research into the growth challenges confronting not only the United States but all advanced economies operating at the technological frontier. My findings can be summarized as follows: the available sources of growth, and the policy requirements of growth, change over time with a country's advancing economic development. In particular, as countries get richer they become ever more heavily dependent on home-grown innovation – as opposed to simply expanding existing activities or borrowing good ideas from abroad – to keep the growth machine humming. And since new firms play an absolutely vital role in the innovation process, that means that removing barriers to entrepreneurship becomes increasingly important to maintaining economic dynamism and prosperity.³

In an effort to identify the kinds of policy reforms needed to reduce structural barriers to entrepreneurship and job creation, the Kauffman Foundation unveiled in July of this year a series of legislative proposals called the Startup Act of 2011.⁴ Let me review now the major elements of this plan:

Welcoming job creators to the United States. First, we propose an entrepreneur visa along the lines of the revised Kerry-Lugar Startup Visa Act. Initially, entrants would be screened for a temporary visa based on either the outside capital they had attracted or revenues from U.S. sales they already had recorded. Permanent work visas (green cards) would be granted once these entrepreneurs had hired a minimum number of U.S. workers. Although the Kerry-Lugar bill imposes a limit on the number of visas granted, we believe a strong case can be made for a visa without any caps. A second, mutually reinforcing idea would grant green cards to foreign students when they receive their so-called STEM degrees – degrees in science, technology, engineering, and mathematics – from U.S. universities. Admittedly, most STEM graduates who are given visas will compete with U.S. workers for jobs. In the long run, however, given the greater propensity of immigrants to found businesses, it is likely many of the STEM graduates permitted entry now eventually will go on to form scale businesses that hire American workers.

³ Brink Lindsey, "Frontier Economics: Why Entrepreneurial Capitalism Is Needed Now More Than Ever," Kauffman Foundation Research Series on Dynamics of Economic Growth," April 2011, http://www.kauffman.org/uploadedFiles/frontier_economics_4_06.pdf.

⁴ Kauffman Foundation, "The Startup Act: A proposal for new legislation aimed at jump-starting the U.S. economy through successful startups," http://www.kauffman.org/uploadedFiles/startup_act.pdf.

Facilitating early stage financing for new firms. The first proposal here is for a capital gains tax exemption for long-held investments in startups. The Small Business Jobs Act of 2010 currently provides such an exemption for investments in “qualified small businesses” (those with less than a \$50 million valuation at the time of investment) held for at least five years. The exemption is currently due to expire at the beginning of 2012, but the National Advisory Council on Innovation and Entrepreneurship (NACIE), created by the Department of Commerce, has recommended a permanent exemption for these critical initial investments in startups. It is appropriate for this idea to be included in any comprehensive startup legislation. NACIE also has suggested a 100 percent exclusion on corporate taxable income earned by qualified small businesses (again, using the same test as for the proposed capital tax exemption) on the first year of taxable profit, followed by a 50 percent exclusion in the subsequent two years. We believe additional incentives along these lines are worthy of support.

Facilitating access to public capital markets. The provisions of the Sarbanes-Oxley Act, especially the verification of internal controls embodied in Section 404 of the act, impose a disproportionate burden on new, small companies and thus act as a barrier to going public. In 2010, Congress implicitly recognized this problem when granting a permanent exemption from the Section 404 audit requirements for public companies with market capitalizations of less than \$75 million. Any comprehensive startup legislation should go further, for a very simple reason: The best judges of whether the benefits of the SOX requirements outweigh their costs are the shareholders of the companies for whose benefit the law was enacted in the first place. Accordingly, rather than simply raising the market cap threshold for exempting smaller public companies from SOX’s requirements, the most logical SOX reform is to allow shareholders of public companies with market valuations below \$1 billion to opt in to at least Section 404 compliance, if not to all of the SOX requirements. Companies whose shareholders do not elect to comply with SOX should have special designations in their exchange listings to denote this fact so that all shareholders, current and potential, are put on notice.

Accelerating the formation and commercialization of new ideas. At this writing, Congress is nearing final passage of patent reform legislation with various provisions whose likely impacts on innovation and startups are not clear. We believe that at least one provision of the legislation – namely, higher fees for faster or better service – is very likely to be positive in its effects. To obtain patent protection for new ideas, inventors first must receive a patent from the U.S. Patent and Trademark Office (USPTO). In recent years, however, USPTO examiners have been unable to keep up with the pace of new applications, to the point where there is now a backlog of over 700,000 patent applications at the office. There is an old saying that “justice delayed is justice denied,” and the same certainly applies to a patent regime that is too slow to process incoming patents.

More than thirty years ago, Congress enacted the Bayh-Dole Act, granting recipients of federal research monies intellectual property rights in innovations discovered with the use of those funds. Since Bayh-Dole was enacted, faculty members typically have been required under their university contracts to use the university’s own technology licensing

office (TLO) as the exclusive agent for licensing the rights to faculty-developed innovations either to the inventors themselves or third parties. In effect, university TLOs have become monopoly licensing agents and gatekeepers, preventing innovative faculty from using their own attorneys or other third parties, or even other university TLOs, to license and commercialize their innovations. The federal government can and should remedy this odd situation. One simple way to do so is to mandate that all federal research grants to universities be conditioned on universities' affording their faculty members the ability to choose their own licensing agents. A university's own TLO could compete in this new environment or, at minimum, provide informational services and mentoring to university faculty members. Licensing freedom for faculty inventors and true competition in innovation licensing would speed up the commercialization of faculty innovations, benefiting the innovators, their universities, and our society.

Removing regulatory barriers to entrepreneurship. Because of their size, small and new businesses bear an especially heavy burden when complying with the multitude of local, state, and federal rules that govern business behavior. To help alleviate this burden, the Startup Act contains two proposals for systemic reform of the federal regulatory process. The first is a simple requirement that all major rules (those with estimated costs of at least \$100 million) sunset automatically after ten years. Rules then would be allowed to lapse unless and until re-proposed and implemented (under new standards outlined next). This would regularly cleanse the books of inefficient and costly rules and, thus, barriers to business formation and growth for all businesses, including startups. The second proposal is for all major rules to be subject to a uniform regulatory review process. Under this screening procedure, no major rules would be implemented or maintained (after a sunset review) unless agencies can determine that the rules' benefits outweigh their costs. Furthermore, the form of these rules should be such that the option chosen is the most cost-effective of the alternatives available.

In addition, the Startup Act offers a new mechanism for monitoring and thereby potentially curbing regulatory abuses and excessive costs at the state and local level. Although the federal government should not step on the toes of local and state governments, it can facilitate healthy competition among these jurisdictions for favorable startup environments. Just as the World Bank has assessed the favorability of the legal environment toward business in different countries through its annual *Doing Business* reports, there should be some recognized entity that does the same (with a special emphasis on policies and practices affecting the formation and growth of new businesses) for each of the fifty states and all cities above a certain size. The *Doing Business* rankings have proven to be an important spur to regulatory reform around the world. A similar *Doing Business* project for jurisdictions inside the United States could have the same result. Both the government and private sector have roles in this effort. Because the underlying data are likely to be costly and difficult to gather, it could be useful and important to charge and fund one government agency with collecting the raw data that could be made available to the public, which would permit either non-profit or for profit rating systems to develop.

The proposals contained in the Startup Act represent a kind of “greatest hits” collection picked from a far broader set of promising reform ideas. Some of these other ideas can be found in a book published this year by the Kauffman Foundation entitled *Rules for Growth: Promoting Innovation and Growth through Legal Reform*. That book was the product of an ongoing Kauffman Foundation initiative – the Project on Law, Innovation, and Growth – that we hope will make further major contributions to our understanding of how to improve our legal and regulatory system to make it more conducive to entrepreneurial dynamism.

Much work remains to be done, but in the current crisis first steps are urgently needed. We believe the proposals put forward in the Startup Act would make excellent first steps toward reviving job creation and prosperity.

Thank you.

Brink Lindsey Biography

Brink Lindsey is a senior scholar in Research and Policy for the Ewing Marion Kauffman Foundation, where he uses his expertise in international trade, immigration, globalization, and economic development to identify the structural reforms needed to revive entrepreneurial innovation, firm formation, and job creation in the wake of the Great Recession.

Lindsey joins the Kauffman Foundation from the Cato Institute, where he served as vice president for research. While at Cato, he helped oversee the Institute's research agenda, developed new research programs, and was the senior editor of *Cato Unbound*, a monthly web magazine, which he founded in 2005. From 1998 to 2004, he was director of Cato's Center for Trade Policy Studies, helping to make it a leading voice for free trade. An attorney with extensive experience in international trade regulation, Lindsey was formerly director of regulatory studies at Cato and senior editor of *Regulation* magazine.

An accomplished author, Lindsey has written several books, including *The Age of Abundance: How Prosperity Transformed America's Politics and Culture*; *Against the Dead Hand: The Uncertain Struggle for Global Capitalism*; and, with Daniel Ikenson, *Antidumping Exposed: The Devilish Details of Unfair Trade Law*. He also is a contributing editor at *Reason* magazine. In addition, Lindsey's writings have been published widely in major newspapers and the leading policy magazines, and he has appeared frequently on television and radio.

Lindsey earned an AB from Princeton University and a JD from Harvard Law School.

**Committee on Government and Oversight Reform
Witness Disclosure Requirement – “Truth in Testimony”
Required by House Rule XI, Clause 2(g)(5)**

Name: Brink Lindsey

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2008. Include the source and amount of each grant or contract.

None.

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

I am not testifying on behalf of any entities. My comments are solely my own, informed by my work with my colleagues at the Kauffman Foundation.

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2008, by the entities listed above. Include the source and amount of each grant or contract.

None.

I certify that the above information is true and correct.

Signature:



Date: September 9, 2011