Written Testimony Before the House Budget Committee
Reigniting American Growth and Prosperity Series: Removing the Burdens of Government Overreach
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Thank you to Chairman Arrington, Ranking Member Boyle, and Members of the Committee for inviting me to testify at this important hearing today. I am honored to appear before this committee to discuss strategies to grow the American economy. The invitation to appear before this committee carries special weight to me personally, as I served as a House Budget Committee staffer under the Chairmen Jim Nussle and John Spratt nearly two decades ago.

Given the broad and far-reaching focus of this hearing, my testimony outlines four key lessons for policymakers who seek to implement policies and reforms aimed at promoting economic prosperity in a sustainable and inclusive way. These lessons are based on my experience as a policymaker at the White House and Treasury Department, rooted in empirical evidence from the economics literature, and are germane to many of the difficult policy decisions currently facing the members of this committee.

To frame any discussion concerning economic growth, it is important to note that the United States is projected to continue a period of modest, but steady, economic growth over the next decade. In the latest projections, the Congressional Budget Office (CBO) projects that real GDP growth will measure between 1.7 percent and 2.7 percent annually between 2024 and 2033.[1] While these ranges are within the recent historical experience, achieving faster growth cannot only improve livelihoods, but also partially mitigate our government's long-term fiscal challenges.

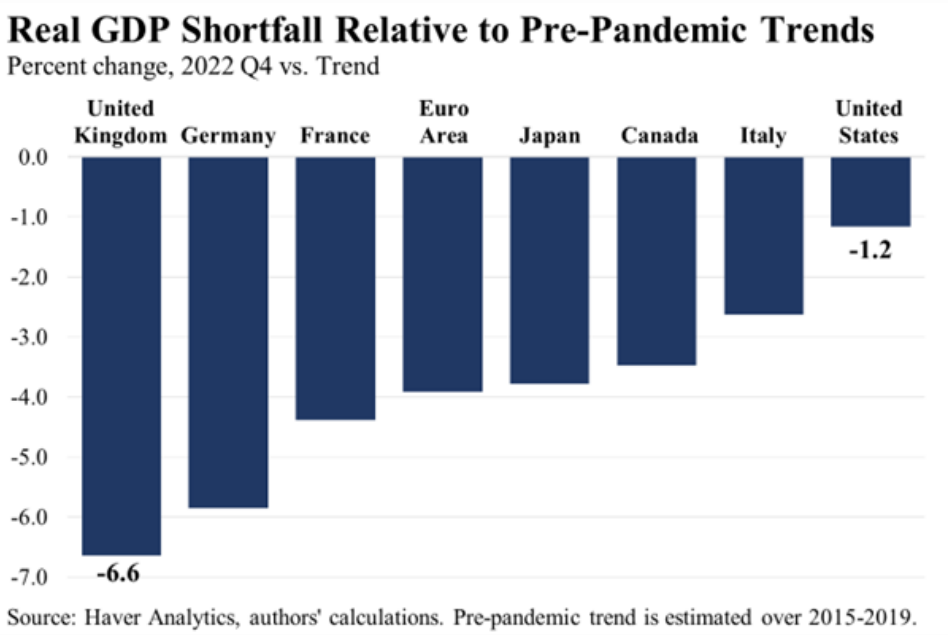
The heart of these growth challenges relates to two key macroeconomic factors. The first is slow growth in the labor force, which is expanding very slowly for the foreseeable future. CBO's projections show that labor, as measured by potential hours worked, is expected to grow by only 0.4 percent annually over the next decade, and by 2023 will be only about 4.3 percent higher than it was ten years earlier.

A second key factor constraining economic growth is productivity. Sluggish productivity growth has been a long-term challenge for the United States and the advanced economies in general, with slow productivity growth characterizing the economy since the early 1970s—with only brief exceptions. CBO projects these trends to continue, with various measures of productivity only increasing by 1 percent to 2 percent a year over the next decade.

These long-term challenges notwithstanding, it is important to recognize that the United States generally fared better than our competitors in the aftermath of the pandemic. As I explained in a March 2023 post published while I was serving as Assistant Treasury Secretary for Economic Policy,[2] the US economy was just 1.2 percent below its expected pre-pandemic level at the end of

[1] https://www.cbo.gov/publication/58848
[2] https://home.treasury.gov/news/featured-stories/the-us-economic-recovery-in-international-context-2023

2022—better than major economies in the G7 and Euro area—while real GDP measured 5.1 percent higher than at the end of 2019 (see chart below). This relative success reflects a more robust turnaround in domestic consumption in the US, which has typically not been the case among our competitors. Importantly, too, the US has experienced a much stronger rebound in the labor market, while also maintaining core inflation rates that are lower than many of the other countries in the sample.



Fortunately, the modest rates of economic growth projected by CBO are not destiny. As I will explain further in this testimony, policymakers can raise projected economic growth by embracing a series of strategies that raise factors of production (e.g., labor and capital), promote competition in the labor market, reinforce the United States as a stable and trustworthy environment for growth, provide appropriate incentives for clean energy production, and maintain public-sector investment in areas that enhance growth. Collectively, these policies can meaningfully increase annual increases in real GDP and markedly improve the standard of living for American households.

Lesson One: We need a new framework for generating economic growth.

In January 2022, Treasury Secretary Janet Yellen delivered a seminal speech on economic growth to the World Economic Forum,[3] introducing a new theory for economic growth termed "Modern Supply Side Economics." In her address, Secretary Yellen discussed some of the shortcomings of traditional supply side economics, while stating that an alternate pro-growth strategy could better boost potential GDP and lead to faster annual gains in GDP.

To start, it's important to note that both modern supply side economics and traditional side supply side economics have the same central goal: a faster expansion in potential GDP (potential GDP refers to the size of the economy if all aspects of the economic are utilized to their fullest) which will lead to higher rates of growth over time. However, while both approaches seek to expand

[3] https://home.treasury.gov/news/press-releases/jy0565

potential GDP, the key difference is in the strategy for doing so. The traditional approach calls for sweeping deregulation, and, in particular, ultra-low rates on investment activity to attract more capital. The modern approach, by contrast, seeks to bolster labor supply and make productivity enhancing investments, while also mitigating economic shocks—like climate-related disruptions—that impede stable economic growth. In the words of Secretary Yellen:

> *What we are really comparing our new approach against is traditional "supply side economics," which also seeks to expand the economy's potential output, but through aggressive deregulation paired with tax cuts designed to promote private capital investment. It is, unquestionably, important to properly implement regulation and maintain a pro-growth tax code, but they are not sufficient and can often be overdone. Modern supply side economics, in contrast, prioritizes labor supply, human capital, public infrastructure, R&D, and investments in a sustainable environment. These focus areas are all aimed at increasing economic growth and addressing longer-term structural problems, particularly inequality.*

From the outset, it is worth noting that the theoretical underpinnings of traditional supply side economics are justifiable; the problem with the traditional approach is that it simply does not work in practice. A key example is the 2017 tax bill (Tax Cuts and Jobs Act, or TCJA) which permanently lowered corporate tax rates and instituted a host of other changes, including sharply lower tax rates on upper-income taxpayers and generous tax reductions for non-corporate businesses. The bill, which according to the Joint Committee on Taxation increased deficits by $1.5 trillion over ten years, substantially altered incentives for investment and was thus an ideal opportunity to test the efficacy of traditional supply side economics.

The TCJA has failed to live up to its promise. In the years following its implementation, many economists have attempted to measure the impact on investment and economic growth—isolating the impact of the tax cut from other macroeconomic changes. Despite its exceptionally high cost in terms of lost revenue, the bulk of economic evidence suggests that the impact on investment and business formation was muted at best. As explained in a Brookings Institution review by William Gale and Claire Hederman, "TCJA was advocated as a way to increase tax-based supply-side incentives that could boost the economy. Discerning the short-term impact on GDP is difficult. But TCJA clearly reduced federal revenues significantly and several pieces of evidence suggest that TCJA's supply-side incentives had little effect on investment, wages, or profit-shifting."[4]

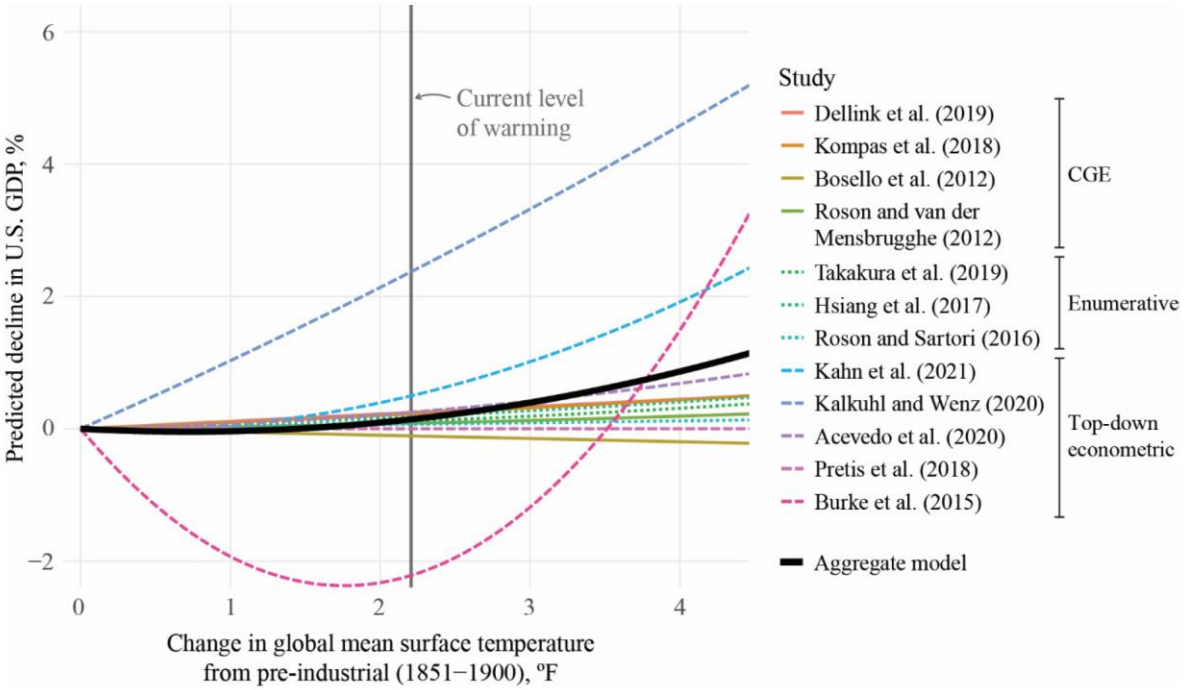
Driven in part by failed traditional supply side experiments like the TCJA, modern supply side economics seeks a new approach that is better rooted in empirical evidence. A key part of this approach is policy reforms designed to lower barriers to work and increase the labor force participation rate. Examples of such policies include an expansion in the Earned Income Tax Credit, better access to paid leave for caregivers, universal access to pre-k education, and subsidies to raise the demand and supply of child care. To take one example, a review of the literature by connecting the cost of child care to women's labor force participation rate found that a 10 percent

[4] https://www.brookings.edu/wp-content/uploads/2021/07/20210628_TPC_GaleHaldeman_TCJASupplySideEffectsReport_FINAL.pdf

decrease in the cost of child care would boost maternal employment on the order of 0.5 percent to 2.5 percent.[5] Similar links have been established for the other policy reforms listed above.

A second pillar of modern supply side economics aims to address the negative implications of economic shocks, including the increasing disruptions from climate-related events like hurricanes, flooding, and persistent drought. The cost of these events is substantial, with one oft-cited calculation by the National Oceanic and Atmospheric Association noting that the US economy last year incurred $165 billion in damages from these disruptions. And a wide range of economic studies have concluded that rising temperatures owing to increased carbon emissions will have a strongly negative impact on GDP, as shown in the figure below.[6]

Figure 1: Individual Damage Functions and Aggregate Function Used for Scenarios including Physical Climate Risks in the FY 2024 Long-Term Budget Outlook



Lesson Two: Robust competition is necessary to harness the power of capitalism—and targeted regulation can help.

Competition is an essential element of capitalism, and lack of competition often impedes the ability of markets to deliver their full economic potential. Perhaps contrary to the central takeaways of traditional supply side economics, more robust regulation in certain circumstances—including in particular the labor market—can improve competition and lead to more efficient economic outcomes. This section focuses on lack of competition in the labor market, but there are other

[5] https://link.springer.com/article/10.1007/s11150-016-9331-3
[6] https://www.whitehouse.gov/wp-content/uploads/2023/03/CEA-OMB-White-Paper.pdf

circumstances to which similar lessons apply. Importantly, too, there are instances where deregulation can improve economic outcomes, with permitting reform serving as one important example.

In explaining sluggish wage growth, productivity growth, and rising inequality over the past several decades, economists have turned to a host of theories ranging from declining union density to the uneven impact of technological change. More recently, however, lack of labor market competition has emerged as a possible explanation for each of these phenomena and has led to a renewed interest in policy reforms designed to improve competition.[7]

The central hypothesis around low labor market competition is that employers have gained market power through a host of factors, enabling them to increase their profits over what would be expected in a competitive labor market. Economists refer to this situation as a "monopsony," which is the labor market equivalent of a monopoly in the product market. In a monopsony, firms hire the amount of labor that will maximize their profits, typically a lower amount that would be employed in a competitive market. This ultimately leads to less employment, lower wages, and diminished economic efficiency.

The alternative to a monopsony is a competitive labor market, whereby firms simply take the market wage as given. Workers are paid the market wage, simply because paying anything less leads to a complete exodus of workers to another firm who is willing to pay the market rate. Competitive labor markets enjoy both higher wages and more jobs.

Perhaps the most obvious way monopsonies can arise is due to highly concentrated markets with few hiring firms relative to the number of workers. One such approach is to apply a measure of market concentration typically utilized by federal regulators (Herfindahl-Hirschman Index) to measure concentration in product markets. In a recent study, economist Jose Azar and co-authors find that 60 percent of US labor markets (by geography), accounting for nearly 20 percent of employment, are "highly concentrated" according to this measure—with generally higher rates of concentration in rural areas compared to cities.[8] The authors speculate that the relatively high concentration in rural areas may account for slower wage growth compared to other labor markets.

Monopsony-like conditions can also arise if workers are tied to their jobs to such an extent that they are reluctant to accept a higher wage offer—such as desire to keep employer-provided health insurance or to avoid a long commute. Ammar Farooq and Adriana Kugler studied the impact of workers moving to a state with more generous public health benefits (which reduces the incentive to stay with an employer for the purpose of maintaining health insurance), finding that more generous public insurance raises job mobility by about 8 percent.[9]

Recent empirical work has focused on workforce labor policies that can diminish competition by restricting workers' abilities to separate from employment. Non-compete agreements, impacting

[7] For an outstanding review of the issues surrounding labor market competition, see the Treasury report "The State of Labor Market Competition," as directed by President Biden's Executive Order on Promoting Competition in the American Economy. Available at https://home.treasury.gov/system/files/136/State-of-Labor-Market-Competition-2022.pdf.

[8] https://www.sciencedirect.com/science/article/abs/pii/S0927537120300907

[9] https://journals.sagepub.com/doi/10.1177/0019793920928066

27.8 percent and 45.6 percent of private-sector workers,[10] can restrict workers' ability to take a better-paying job by threatening legal action for doing so—even in states where non-compete agreements are banned or limited. Economists Michael Lipsitz and Evan Starr studied Oregon's 2008 non-compete ban and found it raised impacted workers' wages by as much as 14 percent to 21 percent—while also shifting more workers in salaried work and improving job mobility.[11]

Empirical studies have also examined the impact of information, namely the disclosure of comparable wages on worker behavior. Depending on the nature of employment, lack of wage transparency can inhibit competition if workers are unaware they are paid less relative to others with similar positions. One study of the faculty and staff at the University of California found that workers with below-median wages significantly increased their job search activity after discovering their peers' wages.[12]

Lesson Three: In the US, failure to raise the debt limit represents a pressing and serious threat to growth.

The current debt limit impasse represents a serious threat to economic growth and will likely result in severe economic disruption if not resolved in a timely fashion. This point is generally uncontroversial among economists. In a recent University of Chicago poll, a panel of distinguished economists were asked whether they agreed with following statement: "Missing payments on the US Treasury security obligations for several weeks would pose a substantial risk of a global financial crisis." Roughly two-thirds polled either agreed or strongly agreed, while only 3 percent disagreed or strongly disagreed; 23 percent were uncertain and 11 percent had no opinion or did not respond. Reputable analysts from organizations such as Moody's and the Brookings Institution have confirmed that breaching the debt ceiling would have severe and perhaps catastrophic economic consequences.

To elaborate on these threats in the context of the current impasse, there are four major avenues through which the debt limit can cause economic harm. The first is through brinksmanship prior to the X-date. The best example of the costs of such disruption can be seen from the 2011 episode, in which financial became increasingly worried in the leadup to the summer 'X date" that the US Treasury would miss a schedule payment, including potentially a payment on the principal and interest due on Treasury securities. In the lead up to the X date, disruptions in financial markets grew increasingly severe. Equity prices fell by 17 percent over time, including one-day declines of roughly 5 percent. Credit markets began to seize up, with spreads (the gap between actual rates and Treasury rates) rising by 65 basis points on BBB corporate debt and by 70 basis points for mortgages. And consumer and business confidence—predictors of willingness to spend and invest—declined gradually over time, taking months to return to pre-crisis levels.[13] Similar signs are already appearing in markets this time around, as interest rates on Treasury bills maturing in early June have spiked meaningfully.

[10] https://www.epi.org/publication/noncompete-agreements/
[11] https://pubsonline.informs.org/doi/abs/10.1287/mnsc.2020.3918
[12] https://pubs.aeaweb.org/doi/pdfplus/10.1257/aer.102.6.2981
[13] https://home.treasury.gov/system/files/276/POTENTIAL-MACROECONOMIC-IMPACT-OF-DEBT-CEILING-BRINKMANSHIP.pdf

The second major threat is through a financial crisis owing to a post X-date impasse in which the Treasury defaults: failing to make a scheduled payment or even missing a principal or interest payment on Treasury securities. Most commentators, in my opinion, seem to acknowledge this as the most pressing threat, but rightly acknowledge uncertainty over both the mechanism through which a financial crisis would occur and the severity of the crisis. The worst potential outcome would be one where Treasuries are no longer regarded as a risk-free asset, meaning not only do investors demand a higher return on both newly issued and existing Treasuries, but risk-adverse, large investors—like money market funds—could immediately reduce their demand for these assets. A fire sale on Treasuries could ensue, impacting credit markets around the world. Corporations and large businesses alike would have difficulty getting credit, as would homebuyers seeking mortgages. A deep recession to rival the financial crisis of 2008 would send the US into a prolonged recession.

The third major threat is related to potential political remedies to resolve the current impasse. In particular, if Congressional negotiations resulted in a package that would sharply curtail non-defense discretionary spending for the near term, we would likely see negative impacts owing to both the aggregate impact of reduced spending and the programmatic impact of this curtailed support. For example, one concern among industries that rely on a well-functioning air travel system is that reduced spending for transportation could lead to sharply higher wait times at airports (due to fewer TSA agents) and diminished flight capacity (owing to shuttered air traffic control towers). These factors combined led Moody's to project that by the end of next year, the Limit, Save, Grow Act would raise the unemployment rate by 0.36 percentage point, cost the economy 784,000 jobs, and slow economic growth by 0.70 percentage points.

An attendant concern is related to the repeal of the tax incentives for clean energy production implemented through the Inflation Reduction Act, which would not only undermine planned projects in the energy sector, but cast uncertainty around the permanence of all tax incentives previously established by Congress. As will be explained in the next section, incentives to address rising and dangerous levels of carbon emissions are a critical pro-growth economic strategy given the near-certainty that climate-related disruptions will increasingly impair economic growth.

Lesson Four: The revolution in energy production will be a major boost to growth in economies that compete in this market.

The world is in the midst of a massive transition in the way energy is consumed and, in particular, produced. This transition promises a series of economic, social, and health benefits that rival some of the greatest achievements in human history—principally related to the gains achieved by mitigating the harmful impacts of carbon emissions. Yet, even laying aside the gains from reducing emissions, the transition promises to offer a major macroeconomic advantage to those countries that invest in low-carbon technologies.

Unfortunately, the United States has been lagging far behind China in terms of aggregate investment. According to Bloomberg, last year global investment in this transition amounted to $1.1 trillion—approximately the same amount invested in the production of fossil fuels and a remarkable doubling of three the investment recorded years earlier. The bulk of this $1.1 trillion

figure was due to investment in renewable energy production (wind, solar, biofuels and other renewables) or electrified transport (electric vehicles and supporting infrastructure).[14] Over half this investment—50.8 percent—was attributed to investment from China ($546 billion), while the US investment amounted to just 12.7 percent of the total ($12.7 percent).

The macroeconomic stakes could not be higher. To start, in a world in which fossil fuel consumption declines, the United States will need to bolster its clean energy production to preserve its hard-fought energy independence. The economic consequences of surrendering energy independence have been crystalized time and again, most recently through the experience of the European Union—which suffered under exponentially rising natural gas prices when Russia weaponized the natural gas supply in the winter of 2021. Europe's economy staggered under the weight of gas prices rising on the order of 1,000 percent in a short period of time, coupled with the persistent threat of energy shortages.

The United States has the opportunity to solidify our industries as leaders in clean energy production, producing employment, wage, and GDP growth in economies around the country. A salient example of this opportunity is the electric vehicle industry, which promises to overcome cars produced with internal combustion engines as soon as 2027. As outlined in the 2022 Economic Report of the President, the economic potential is massive: nearly 1 million Americans work in auto production, the output of the motor vehicle and parts industry amounts to $500 billion each year, and the value of the worldwide electric vehicle market is projected to increase by nearly five-fold to $800 billion over this decade.[15] Maintaining a global leadership role in the electric vehicle industry can be a economic gain for decades. Other clean industries offer similar benefits. For example, clean energy generation offers a sizeable opportunity for high-paying employment, in part due to the size of the potential investment and in part due to the labor-intensive nature of industries like solar, wind, and geothermal energy.

A final benefit comes in the form of lower energy expenditures for consumers, an occasionally underappreciated gain from the transition to clean energy. As detailed in a recent report from the Rhodium Group, consumers stand to gain through three primary mechanisms. One is the utilization of consumer tax credits, which lower the costs of transition passed on to households. A second is the total demand of energy consumed due to increased efficiency, which lowers total expenditures even if actual prices don't change. A third factor is the per-unit cost of energy, with lower demand for natural gas lowering the cost of gas for all sectors in the economy. All told, the Rhodium group estimates that these factors will help lower average household energy spending by $411 to $566 by 2030.[16]

In summary, there are many policies which can either raise or lower economic growth. While impact on economic growth is not the only factor that can determine a policy's appeal, it is hopefully an important factor—especially in the context of sluggish projected long-term growth.

[14] https://about.bnef.com/blog/global-low-carbon-energy-technology-investment-surges-past-1-trillion-for-the-first-time/
[15] https://www.whitehouse.gov/wp-content/uploads/2022/04/Chapter-7-new.pdf
[16] https://rhg.com/wp-content/uploads/2021/10/Rhodium-Group_Pathways-to-Paris-A-Policy-Assessment-of-the-2030-US-Climate-Target.pdf

A national economic agenda that embraces the lessons of modern supply side economics, fosters competition across a range of markets, avoids manufactured financial crises like the debt ceiling impasse, and actively seeks to investment in the clean energy transition will surely lead to better outcomes and a more prosperous future for American families.