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THE POSITIVE ECONOMIC GROWTH EFFECTS OF THE TAX CUTS AND JOBS ACT

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BEFORE THE

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THE POSITIVE ECONOMIC GROWTH EFFECTS OF THE TAX CUTS AND JOBS ACT

THURSDAY SEPTEMBER 6, 2018

UNITED STATES CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to notice, at 2:30 p.m., in Room G–50 Dirksen Senate Office Building, the Honorable Erik Paulsen, Chairman, presiding.

Representatives present: Paulsen, Comstock, LaHood, Maloney, Adams, and Beyer.

Senators present: Heinrich, Klobuchar, Hassan.

Staff present: Ted Boll, Colin Brainard, Kim Corbin, Hannah Falvey, Connie Foster, Ricky Gandhi, Natalie George, Colleen Healy, Karin Hope, Paul Lapointe, Alice Lin, and Tommy Wolfe.

OPENING STATEMENT OF HON. ERIK PAULSEN, CHAIRMAN, A U.S. REPRESENTATIVE FROM MINNESOTA

Chairman Paulsen. I call the committee hearing to order.

Most economists say that it is too soon to know how the Tax and Jobs Act will affect our economy, and I agree with them. That is because tax reform was not designed to give a short-term sugar rush to the economy. It was intended to improve the levers that drive economic growth—more work, more capital, and more productivity—so that in the long run, American workers and families enjoy more prosperity and opportunity.

The evidence shows that this is already beginning to happen. As Federal Reserve Chairman Jerome Powell put it recently, the economy is doing very well. The Bureau of Economic Analysis recently revised upward its estimate of GDP growth to 4.2 percent in the last quarter, and survey after survey shows that business optimism is surging. Individual tax relief has allowed people to keep more of their hard-earned money so that it is worth it to work hard, to find a job, and to keep reaching for that next opportunity.

By investing in individuals and those who employ them, we are putting a downpayment on a more prosperous future for all Americans. After business reforms became law, companies started to invest in their workers and businesses in ways that lead to a more productive workforce. That, in turn, leads to growing paychecks and higher economic growth in the long run.

This reform fought for American workers by attracting investment here at home, and encouraging companies to keep high-value intellectual property in America instead of overseas. It has been a game changer.

Profits earned in international markets are returning to the United States where they can be invested in greater opportunities for our people. Though we should not base the success of tax reform on what is happening in the short term, we are already seeing positive effects from these long-term incentives to work and invest.

Business investment, which paves the way for future wage and economic growth, is picking up. After all, an employee's wages can only increase following the decision by a business to invest more in its workers and company. We want that to be an easy decision.

Since the Tax Cuts and Jobs Act became law, business investment has outperformed similar periods in 2017, and far exceeded the weak and sometimes negative growth in the final year of the Obama Administration.

This chart comparing second-quarter growth rates shows how much business investment has increased in the last two years compared to the last year of the Obama Administration. In fact, since tax reform became law we have seen an average growth rate of 10 percent so far this year. That is great news.

Yes, it will take time for tax reform to have its full effect on investment and wages, yet the Congressional Budget Office noticed rising wages in its latest report on Federal revenues. Economists here at the Joint Economic Committee also analyzed 21 different measures of wage growth and inflation, and 20 of the 21 showed real wages rising faster during this Congress and Administration than during the Obama—era recovery.

Small business owners are also seeing benefits, with small business optimism, new hiring, worker pay increases, and investment plans near record highs. And for those who claim that tax reform only benefits the wealthy, there is great news for those Americans who struggle the most in a very weak economy, those with less education, minority workers, and people with disabilities.

Unemployment is at its lowest level since the year 2000, but the untold story is that it is falling faster for those disadvantaged groups than for the groups that tend to do very well. It is also worth noting that the Joint Committee on Taxation found that during the time individual tax relief from the Tax Cuts and Jobs Act is in effect, the greatest percentage of tax cuts will go to those with incomes between $20,000 and $50,000, and that millionaires will actually pay a larger share of the Federal tax burden with tax reform than they would without it.

Tax reform was just a first step. We should continue to improve our Tax Code to meet the challenges of an ever-changing global economy, but the Tax Cuts and Jobs Act put America on a much stronger economic footing, which will make many of our Nation's challenges easier to tackle.

I look forward to a very distinguished panel of witnesses, including one from my home State of Minnesota. And before I introduce our panel of experts, I would now like to recognize the Ranking Member, Senator Heinrich, for a period of five minutes for his opening statement.

[The prepared statement of Chairman Paulsen appears in the Submissions for the Record on page 22.]

OPENING STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, A U.S. SENATOR FROM NEW MEXICO

Senator Heinrich. Thank you, Chairman Paulsen.

I agree with you that it is useful to look at the Republican tax law's impacts on our economy, on working families, and our Nation's economic position. I suspect we may come to some different conclusions.

At best, the Republican tax bill was a massive missed opportunity, squandering $1.9 trillion on tax breaks for those who did not need them at a time when our Nation could least afford it.

The bill does little to help working families. Instead, it worsens inequality and burdens the next generation with trillions in additional debt, which could jeopardize vital programs and services that families count on.

At a basic level, the law simply has not lived up to Republican promises. The White House and our Republican colleagues promised families a $4,000-a-year increase in income. That simply has not happened.

In fact, hourly wages adjusted, which you can see in this chart here, adjusted for inflation are actually going down, not up. And as you can see in the chart on wage growth, the average hourly wage for production and nonsupervisory workers, our best measure of the typical workers take-home pay, was lower in July of 2018 than in July of 2017 after adjusting for inflation.

In other words, wages simply are not keeping pace with the cost of living. That means it is harder for a typical family to buy groceries, to pay rent, to put gas in the tank.

After decades of wage stagnation where the median workers' wages have grown by 6.1 percent over the last 38 years, people need a real raise, not empty promises.

The reality is that the Republican tax bill is doing exactly what virtually all mainstream economists and Democrats said it would do. It is delivering the vast majority of its benefits to large corporations and wealthy individuals, while leaving working Americans behind. Stock buy-backs are now at record highs, with Goldman Sachs projecting that they will reach a trillion dollars by the end of the year.

While buy-backs benefit company executives and other wealthy shareholders and investors, they do nothing for half of all Americans who own no stock. And since foreign investors own 35 percent of U.S. stocks, much of the benefits of these buy-backs are actually flowing overseas.

It is important to remember that each dollar spent on buy-backs is a dollar not spent on investing in factories, or plants, in training, or boosting workers' wages.

We could have gone a different direction. My Republican colleagues could have joined with Democrats to craft deficit-neutral pro-growth tax reform. But by adding $1.9 trillion to the national debt, the tax law gives Republicans their latest justification to target Social Security, Medicare, and Medicaid.

Just last month, Republican Representative Steve Stivers, the Chair of the NRCC, expressed support for turning Medicare into a voucher program. Republicans are again pushing to cut health care coverage that families receive through Medicaid, and go after Medicare and Social Security which seniors and their families count on.

In my State, more than half of New Mexicans depend on these three programs, and the Affordable Care Act, to help with health care and living expenses. Cuts to these programs would have devastating consequences for families who have seen little to no benefit from the tax cuts.

Recent economic projections remind us that any growth bump from a Republican tax cut will be short-lived. So Republicans will try to take our eyes elsewhere. Republicans will point to the second quarter GDP growth, but will neglect to mention that we have hit higher levels multiple times in this recovery, or that long-term projections remain unchanged.

In fact, economists at the San Francisco Fed recently projected that the tax cuts could have zero impact to growth, due to the poor timing of the law.

They will talk about this year's job growth, but fail to acknowledge that 2018 and 2017 look basically the same as 2016 and 2015. In fact, as this chart on job growth shows, the economy is adding fewer jobs per month since President Trump took over.

Now Republicans want to make permanent the temporary provisions of the bill, to dole out a second helping of tax breaks. But doing so would deliver two-thirds of the benefits to the wealthiest 20 percent, and add nearly $800 billion more to the debt by 2028. The Republican tax law was the wrong medicine at the wrong time. The solution is not to take more of it.

I want to thank each of our witnesses here today for your testimony, and I look forward to a very spirited discussion.

[The prepared statement of Senator Heinrich appears in the Submissions for the Record on page 23.]

Chairman Paulsen. Thank you, Senator Heinrich. I will now introduce our witnesses.

Mr. Scott Hodge is the President of the Tax Foundation. During his tenure, the Tax Foundation has become one of the most influential organizations on tax policy in Washington and in State capitals. He led the development of the Tax Foundation's most successful programs, including the Taxes and Growth Dynamic Tax Modeling Project. Mr. Hodge has published extensive research on tax policy and government spending, and has edited three books on the Federal budget and streamlining government.

Before joining the Tax Foundation, Mr. Hodge was the Director of Tax and Budget Policy at Citizens For A Sound Economy. In the 1990s, he helped design proposals that influenced major tax legislation in 1997, 2001, and 2003. He also analyzed policy at the Heritage Foundation, and founded the Heartland Institute.

Mr. Hodge holds a B.A. in Political Science from the University of Illinois at Chicago.

Also with us is Dr. William Dunkelberg, who is the Chief Economist of the National Federation of Independent Business, or NFIB, which is the largest small business association in the United States, and well known for its advocacy on behalf of small and independent business owners.

Dr. Dunkelberg is also a Professor Emeritus of Economics at the School of Business and Management at Temple University, where he formerly served as both the Dean and Director of the Center for the Advancement and Study of Entrepreneurship. He is a contributor on economic forecasting panels for major news outlets, and authored numerous books and articles. Previously he served as an Advisor to the Secretary of Commerce, and was appointed to the Consumer Advisory Council of the Federal Reserve System. He also co-founded Wireless Energy Solutions, was an economic strategist in the private sector, and served as Chairman of Liberty Bell Bank. Dr. Dunkelberg received his B.A., M.A., and Ph.D. in Economics from the University of Michigan.

And now I want to welcome our witness from Minnesota, Mr. John Hinderaker, who is the President of the Center of the American Experiment, a public policy organization known as Minnesota's think tank. The Center researches and produces papers on topics ranging from Minnesota's economy, State and local governance, to crafting and promoting creative solutions that emphasize free enterprise, limited government, personal responsibility, and government accountability.

Before becoming President of the Center of The American Experiment, Mr. Hinderaker spent 41 years as a litigator with Faegre and Benson and its successor Faegre, Baker, Daniels, and received numerous awards and recognitions for his work.

Mr. Hinderaker has appeared as a commentator on major television networks, and is a frequent guest and guest host on national radio programs. In addition, Mr. Hinderaker has lectured at colleges and universities ranging from Harvard Law School to my alma mater St. Olaf, where we both have daughters attending.

Mr. Hinderaker holds an A.B. from Dartmouth College and a J.D. from Harvard Law School. Thanks for making the trip to be with us.

And our final witness with us this afternoon is Dr. Benjamin Harris, who is a Visiting Associate Professor at Kellogg School of Management at Northwestern University, with a focus in tax, budget, and retirement policy. Dr. Harris also serves as the Chief Economist at Results For America.

Previously Dr. Harris served as the Chief Economist and Economic Advisor for Former Vice President Biden. He later was Senior Economic Policy Advisor at Rokos Capital Management, and served in roles at The Hamilton Project, Brookings Institution, the Urban Brookings Tax Policy Center, the Council of Economic Advisers, and the House Budget Committee.

He holds a Ph.D. in Economics from George Washington University, and other degrees from Tufts, Cornell, and Columbia University.

Welcome, all of you. You will each have five minutes for your presentation. And with that, we will begin with Mr. Hodge and follow in order. Mr. Hodge, you are recognized for five minutes.

STATEMENT OF MR. SCOTT A. HODGE, PRESIDENT, THE TAX FOUNDATION, WASHINGTON, DC

Mr. Hodge. Thank you, Mr. Chairman, Mr. Heinrich, and members of the Committee. I appreciate the opportunity to talk to you today about the economic benefits that we expect to see from the Tax Cuts and Jobs Act.

You know, few organizations have modeled these effects as much as we have at the Tax Foundation over the last few years. The Act contains a number of very pro-growth elements, such as cutting the corporate tax rate, moving to full expensing for capital investments, that will not only result in higher levels of GDP, higher wages, and more jobs, they will make the United States more competitive globally.

And these provisions will improve incentives to work and invest, which is why, when we used our Taxes and Growth Macro Economic Model to score the plan, we found out our model shows it will have a positive long-term effect on the economy. And I do want to underscore "long term."

And while we have seen a lot of great economic data recently, and it has been very encouraging, it is unrealistic to expect major tax policy changes like this to produce immediate results. And I know politics can be very impatient, and the media wants headlines, but tax reform and economic growth do not fit within a 24-hour news cycle.

In fact, this kind of reminds me, this whole debate reminds me of a long car ride with your children. About an hour into the car ride, they're kicking the back of your seat asking, "Are we there yet? Are we there yet? Are we there yet?"

But like a long car ride, economic changes, and major changes like this, take time and patience. And we have to tune out the chatter from the back seat. And over the next decade and beyond, our model predicts what we might call an arc of economic growth, rising and falling with the temporary or permanent nature of the various tax provisions in the bill.

In the first few years, the economic impact will be modest as companies begin to invest more in plant and equipment and building the Nation's capital stock, but by 2025 the economy will be, we estimate, 3 percent larger than it otherwise would be.

However, in 2026, when the individual provisions expire and the 100 percent bonus expensing phases out, the economy will begin to shrink a little bit and move back to normal baseline.

But on average over the next decade, the level of GDP will be about 2 percent larger than baseline. Now it doesn't sound like much, but that translates into a cumulative $5.3 trillion worth of additional GDP over the next decade.

Now if we look at the very long term, as our model does, we estimate that the new tax law will boost the level of GDP by 1.7 percent, boost wages by 1.5 percent, and create 340,000 additional full-time jobs.

Now nearly all of those long-term effects are the result of the permanent cut in the corporate tax rate. However, our model predicts that if the Congress were to make the expensing provision permanent, and the individual rates permanent, you could multiply those results considerably.

In fact, dollar-for-dollar the most pro-growth tax measure that Congress can enact is making that permanent—the expensing provision permanent. And all of those economic benefits translate into higher after-tax incomes for all Americans.

The tax cuts themselves of course are great for taxpayers, but by 2025 we expect that the additional economic growth and wage growth will lead to a rise in after-tax incomes of 4.6 percent on average for all taxpayers. And the model actually indicates that even, even should we face a fiscal cliff when the individual provisions expire, after-tax incomes for all taxpayers will still be higher because of the economic growth and wage growth than they would have otherwise been had there been no tax cut.

Now nonetheless, Congress should make those individual provisions permanent to avoid an unfair tax increase.

Well, Mr. Chairman, I'll conclude with just a simple reminder. The Tax Cuts and Jobs Act is barely nine months old. Most kids are not even crawling by that age. So it's really too soon to ask, "Are we there yet?"

And let's not forget that one year ago the U.S. had the highest corporate tax rate in the industrialized world. We had one of the worst cost-recovery systems anywhere for capital investments. And we had one of the most progressive personal income tax systems anywhere in the world.

Today we have one of the most competitive corporate tax systems in the world. And these changes will lift wages, will create jobs, and will grow the economy if we give it time. But the prosperity will not last unless we make all of these tax changes permanent, and the sooner the better.

So with that, Mr. Chairman, I am happy to answer any questions you may have.

[The prepared statement of Mr. Hodge appears in the Submissions for the Record on page 25.]

Chairman Paulsen. Thank you, Mr. Hodge.

Dr. Dunkelberg, you are recognized for five minutes.

STATEMENT OF DR. WILLIAM C. DUNKELBERG, CHIEF ECONOMIST, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Dr. Dunkelberg. Chairman Paulsen and Ranking Member Heinrich, thank you very much for the opportunity to come and talk to you about the JCTA from the point of view of the small businesses.

The small business sector is very important to the economy, estimated to be about 48 percent of private GDP. That is a lot of output. And roughly half of the private-sector labor force. So if you want to worry about productivity, then you really need to worry about investment in the small business sector, because there are a lot of workers there, and they get included when we calculate our average productivity growth numbers. They are very, very important.

Now over the last 45 years, NFIB, National Federation of Independent Business, has taken a random sample of its hundreds of thousands of member firms and sent out a questionnaire asking a bunch of information about how the company is doing, and what people expect.

And in that questionnaire, which by the way stays pretty much the same; we don't change the questions so we don't lose the meaning of the index, ten of those questions go into this index that we call the Small Business Optimism Index. And that has proved to be very informative over the past 45 years.

It reached its record high level in July of 1983 of 108, and very recently almost hit that again at 107.9 last month. The average of the index over the 45 years is about 95, but just to give you perspective on how important it can be and the changes and what the changes tell us, in October of 2016 the average index was 95. And that is three points below the average.

In the first week of November, the index was still 95. How do we know that? Remember we mail out 10,000 interviews. They come back, and we can kind of do a before-and-after analysis. So it was 95 before the election results were announced. Once announced, the index rose to 102 in the remaining months of November, and hit 105.8 in December, and it hasn't looked back. Since then, we've been averaging well over 105 for all those months since.

Now small business owners had no idea really what the policy details were going to look like. All they knew was there was going to be a change. There was a new management team, and they thought whatever they were going to get, I guess, was going to be better than what they had. And that made them very optimistic about the future and what they can attain in the future.

So if you look at how the index has done, it has really gone from 105 to almost 108, almost to the record high, since we changed the management team and we got a new set of economic policies.

Now originally the index was dominated by the expectations component. So there are 10 components, as I pointed out, and 5 of them are kind of "Do you expect business conditions to be better in six months?" "Is now a good time to expand your business? And "What about expected real sales?" Those kinds of expectations questions. That dominated the index and drove it up over 105.

Since then, the mix of this has changed. It has become a very muscular index, dominated by record high job openings, record high plans to hire, record high capital spending plans, record high reports of higher income, and record high plans to increase inventory investments.

So that's the meat of Gross Domestic Product. And of course we are really happy to see that. And that means also of course we have had really great experience with employment gains over that period of time.

So just as an example, capital spending in November of 2016 was reported by 55 percent, now 66 percent earlier this year. So an 11-point increase in the percent of our owners investing in capital equipment and expanding their business. So that has worked out very well.

We ask a question every time: What's the most important problem facing your business today? We have ten options. Outside of Volker and inflation back in the olden days, what's dominated is taxes and the cost of regulatory compliance, another tax on small businesses. So that's been averaging around 21 percent in the olden days, now fallen as low as 13 percent since the TCJA had been passed.

So it had good features, as you mentioned. The expensing, and the lower tax rates. Also 199A was very good, because it finally looked at the pass-through organizations, and we're happy to have that happen, as well. But what we see is that they have really responded to the change in policy, and they are putting their money where their mouth is. You look at what they've planned to do with the money that they hope they will get by the tax change, and they're going to invest and hire. And that's the key. And of course productivity will increase as long as we continue to invest in our workers in the small business sector.

So we would like to see permanency, as well, so we can depend on it. Uncertainty is the enemy of growth. So we don't want uncertainty.

So thank you very much for this opportunity, and we will answer questions later.

[The prepared statement of Dr. Dunkelberg appears in the Submissions for the Record on page 39.]

Chairman Paulsen. Thank you, Dr. Dunkelberg.

Mr. Hinderaker, you are recognized for five minutes.

STATEMENT OF MR. JOHN H. HINDERAKER, PRESIDENT, CENTER OF THE AMERICAN EXPERIMENT, GOLDEN VALLEY, MN

Mr. Hinderaker. Chairman Paulsen, Ranking Member Heinrich, members of the Joint Economic Committee:

Thank you for your invitation to provide testimony for this important hearing. My name is John Hinderaker and I am President of Center of The American Experiment.

The subject of my testimony is "The Impact of The Tax Cuts and Jobs Act on The Economy of Minnesota" where my organization is headquartered.

While only eight months have elapsed since the Act became effective, already its positive effects are becoming obvious. We have identified at least 34 Minnesota companies, based on news reports, that have announced new hiring, wage increases, and so on, as a direct result of the Act. No doubt the companies on which there are news stories represent only a small fraction of those who have made such investments in Minnesota in consequence of the Act.

Because of the Act's recent passage and the fact that publication of State-level data often lags behind national data, we are not yet able to measure the law's impact on Minnesota by some metrics—for example, GDP—but there is every reason to believe that Minnesota's GDP has risen strongly, along with that of the Nation as a whole.

On the other hand, the Bureau of Labor Statistics updates State-level jobs and income data monthly. And here we can clearly see the positive effects of the Tax Cuts and Jobs Act. Figure one. Figure one shows the monthly net change in private jobs in Minnesota. The positive impact of the Act, starting in January 2018, pretty much jumps off the chart.

The 2018 hiring peak is nearly 20,000 jobs above the 2017 hiring peak. This effect on jobs is even more clear in figure two, also from the Bureau of Labor Statistics, but seasonally adjusted and from a different data set.

Here again you can see the strong employment growth that began with the passage of the Tax Cuts and Jobs Act. It's the biggest jobs gain in at least a decade. Wages in Minnesota are rising, as well. You can see that in figure three, which shows average weekly earnings in Minnesota. Again, the upswing that began with the passage of the Act is unmistakable.

Average weekly earnings in Minnesota have risen by 2.7 percent since January 2018, more than double the 1.2 percent increase in the same period of 2017.

Figure four shows seasonally adjusted hourly earnings of all private employees in Minnesota. You can see that wage growth had stagnated during the second half of 2017, but took off with the passage of the Act.

The Tax Foundation estimates that the Tax Cuts and Jobs Act will add 6,789 full-time equivalent jobs to Minnesota's economy, and yield a gain of after-tax income of $722.40 for each of the State's middle-income families. The data indicate that these projections are well on the way to being realized.

It is worth noting also that Minnesota's Office of Management and Budget expects the Tax Cuts and Jobs Act to boost Minnesota's GDP growth. In February 2017, the office's forecaster, IHS Markit, predicted good GDP growth driven by the Act. But in November 2017, it didn't look as though the Tax Cuts and Jobs Act was going to pass. So the Office of Management and Budget lowered Minnesota's fiscal forecast, predicting a deficit of $188 million for the current biennium. Then, when the Act did pass in December, the forecast was revised again. With the effect of the tax cuts reinstated, OMB now predicted, instead of a deficit, a surplus of $329 million.

So Minnesota's Office of Management and Budget is aligned with other forecasters who see the Tax Cuts and Jobs Act producing stronger economic growth in Minnesota.

So the evidence is clear that the Tax Cuts and Jobs Act is already helping Minnesota's families. With that, I thank you again for the opportunity to testify and look forward to your questions.

[The prepared statement of Mr. Hinderaker appears in the Submissions for the Record on page 65.]

Chairman Paulsen. Thank you.

And, Dr. Harris, you are recognized for five minutes.

STATEMENT OF DR. BENJAMIN H. HARRIS, VISITING ASSOCIATE PROFESSOR, KELLOGG SCHOOL OF MANAGEMENT, NORTHWESTERN UNIVERSITY, EVANSTON, IL

Dr. Harris. Thank you. I would like to begin this testimony by thanking Chairman Paulsen, Ranking Member Heinrich, and all members of the Committee for inviting me to testify at this important hearing. It is truly an honor to receive this invitation.

I will start by noting that independent organizations have generally reached the consensus around the impact of the TCJA. A collection of independent entities have found that the initial boost provided by the bill will eventually wear off, slowing the growth rate in later years as rising interest rates due to growing deficits and expiration of the tax cuts drag down the economy.

Projections also find that the legislation drives up both public debt and borrowing from abroad, giving foreign investors a larger claim on domestic income, leaving income earned by Americans little changed. For example, CBO projects that the bill will grow real GNP by just one-tenth of one percent by 2028.

These projections aside, I would like to raise three main concerns with the legislation.

My first concern is that the bill is poorly designed to spur new investment in a cost-effective way. One of the most significant shortcomings of the bill is the large windfall gain provided to investors. In this context, windfall gains tax cuts awarded to individuals and businesses for something they have already done. The corporate tax cut and the deemed repatriation on foreign earnings are classic examples of windfall gains.

Since the tax cuts impact on growth is largely determined by whether it raises investment or labor supply, windfall gains represent a wasted opportunity to boost the economy, and are one of the primary reasons why so many project the Act to have a tepid impact on long-run growth.

A related concern with the bill is that it will actually reduce certain types of investment. According to CBO, the bill will lower combined investment in residential real estate and intellectual property by over $200 billion.

My second concern is that the bill's steep increase in debt will hurt middle class families. As members of this Committee are well aware, our Nation faces serious long-term fiscal challenges, with dire projections of a public debt explosion even before the bill became law. But the bill has greatly exacerbated concerns over soaring debt, raising deficits by roughly $2 trillion over the next decade. And these costs will rise substantially if the legislation is made permanent.

There are plenty of concerns with exploding debt, but one particular worry is if policymakers respond by cutting major public programs such as Social Security and Medicare. Social Security is the bedrock of the U.S. retirement system, with roughly half of elderly households relying on these benefits for all or nearly all of their retirement income. While another quarter of elderly households depend on Social Security for a substantial portion. Cutting it would be a major blow to older Americans.

Widespread cuts to Medicare and Medicaid would also be exceptionally harmful to American retirees, especially those with limited income or assets who cannot plausibly return to the labor market.

An additional concern is the impact of higher interest rates on middle class families. The higher debt levels in the bill will raise interest rates, making everything from home ownership, to student loans, to credit card payments, more expensive for American households, even before they're asked to begin repaying the massive debt incurred under this tax law.

My third concern is that the bill is poorly designed to benefit workers. In broad terms, there are two primary ways the tax cut can increase wages. One is by increasing worker productivity through higher business investment. Under this scenario, tax reform can eventually raise wages by first increasing the level of investment, which can then boost worker productivity, which can then in theory boost wages.

There are plenty of caveats to this situation, but the key point is that without higher investment there is no plausible argument for a tax cut raising wages. Legislation can also increase after-tax wages by directly cutting taxes on labor. This can effectively be done through a payroll tax cut, a refundable credit based on earnings, or an EITC expansion, but cuts in income tax rates are generally ineffective ways to boost middle class wages because so many families pay little to no income taxes.

Unfortunately, in my opinion, the bill receives poor marks on these various criteria. Future academic studies will shed light on the bill's investment impact, but initial evidence suggests that it has primarily booster share repurchases rather than investment.

Distributional analysis shows the tax cuts are of limited value to working families. Indeed, families will begin paying more in 2026, with higher tax bills indefinitely thereafter.

Lastly, the bill's relatively favorable treatment of businesses compared to workers may exacerbate the enduring fall of labor's share of national income, meaning an even smaller piece of the pie for workers across the country.

In sum, the combination of limited new investment, substantially higher debt, and potential cuts to critical programs to offset that debt, and little positive impact on wages, means that the bill is unlikely to achieve its purported economic effects.

Thank you, and I look forward to your questions.

[The prepared statement of Dr. Harris appears in the Submissions for the Record on page 80.]

Chairman Paulsen. Thank you, Dr. Harris.

And with that, during our question and answer period, I would remind Members to keep their questions to five minutes, and I will begin.

Mr. Hodge, you had outlined how our corporate rate now has made us much more competitive. And the long-term effect is very positive, obviously, for our economy. So two questions.

One, debt and deficits are obviously very important, and they are a problem. But—are they a problem of not having enough revenue or growing—mandatory spending? And two, is our long-term debt problem—easier to tackle in a growing economy, or in a weak economy?

Mr. Hodge. Thank you, Mr. Chairman. In fact, actually the CBO addressed some of that recently in a report. They were looking at projecting out both revenues and spending over the next decade, and they found that revenues—they estimate that revenues will be about 17.2 percent of GDP over the next decade, which is about at the national average over the last 50 years.

Meanwhile, spending will be about 22 percent of GDP over the next decade, which is a couple of percentage points higher than where they've been over the last 50 years.

So, really, spending is the problem. Entitlement spending is out of control. And it seems as though, according to CBO, revenue will pretty well stabilize at around 17 percent of GDP.

What is important, though, if you are looking at deficit reduction, is enacting policies that do not do harm to the economy while you are trying to reduce the deficit. And it is interesting that you mention that, because there was a new report recently out of the IMF. They looked across the globe at all of the different countries that have cut their deficits at one time or another through tax of spending policies, and which ones did the most harm and which ones did the most good.

And they found that cutting spending was the most beneficial for both reducing the deficit and for economic growth. Whereas, raising taxes did the most harm for economic growth, which ended up being counterproductive for trying to reduce the deficit.

And that is based on an IMF survey of countries across the globe over the last few decades. So really we need to address the spending problem, and leave the economic growth to come from the Tax Cuts and Jobs Act.

Chairman Paulsen. Dr. Dunkelberg, you had mentioned 45 years of surveys with your membership currently almost at a record high showing overwhelmingly positive news from the small business community since tax reform.

Because small business owners need to make long-term and long-range plans for their companies, are there plans to hire and give more pay raises and make more investments a signal that they expect long-term growth at their companies and their businesses?

Dr. Dunkelberg. I certainly would interpret it that way. All the decisions that small business owners make are always about the future. It's all about the future, and not about the past.

So decisions they are making now to spend and to hire are commitments to the future, not just six months or a year, but much longer than that, especially when you look at the fact that we have a record high number now saying it is a good time to expand their business. That is heavy-duty stuff, not just a small investment in a new piece of equipment.

All of that is very important. So we think they are very optimistic about the future, not just the immediate future but long term. They see a different set of policies that are conducive to growth in the economy, and that are encouraging them to do the kinds of things that will raise worker productivity.

And to go along with that we have a record high percentage who are now already reporting that are raising worker compensation. So as our workers become more productive, we do pay them more.

Chairman Paulsen. Mr. Hinderaker, thank you first of all for providing so much information on the economic conditions in Minnesota. I am sure that other states are seeing some similar results, based on my conversations with colleagues regarding Federal tax reform.

What do you expect would happen in Minnesota, for our economy, if our State followed suit and actually lowered some of the tax burdens on its residents or businesses and had a focus along that front?

Mr. Hinderaker. Well, two things. In the short term, I think we would see a boost like we have been seeing from the Federal legislation. I think in the long term, it would be even more important because those tax cuts would make Minnesota competitive. So not only is it a good thing in the way that the Federal tax cuts are a good thing, but it is an especially good thing because you get the benefits of the tax cuts but then you get the secondary benefit that we are no longer one of these blue states with the highest taxes—I think currently the sixth highest tax burden. And those cuts would make Minnesota more competitive.

So they would have tremendous long-range benefit for the State.

Chairman Paulsen. Senator Heinrich, you are recognized for five minutes.

Senator Heinrich. We are alone up here.

[Laughter.]

Mr. Hodge, I appreciated your analogy about the kids in the backseat asking, “Are we there yet?” but I would like to point out that hourly workers have been asking, “Are we there yet?” for 38 years, while their wages have stagnated, despite the fact that we have seen immense increases in productivity over that time.

One of the reasons I think there is some frustration, or impatience, as you put it, with this tax law is that there was a fairly explicit promise made by the President, and some Members of Congress, that this would result in $4,000 worth of additional wages.

Talk to me about that prediction. How does the data match up to a $4,000 increase in wages as a prediction?

Mr. Hodge. Well there is a lot at work here in the wage data. So I think we have to be a little bit careful with it.

First and foremost, if you read a recent op-ed by Robert Samuelson in The Washington Post, he talked about a study that I think was very important and how over the last few decades the growth in health care costs has really put a damper on wage growth——

Senator Heinrich. We are talking about—are we seeing an increase in wages that you can even count as $1,000, in four digits?

Mr. Hodge. We have done this analysis, and our results were different from what the Council of Economic Advisers came up with, but ours was long-term results as well. Their analysis was a long-term estimate. And I think we have to be patient and stop asking, “Are we there yet?”

Senator Heinrich. How long should workers be patient, given what they have gone through in the last four decades?

Mr. Hodge. This could take just a few years. And I think we’re going to see this as soon as the expensing provisions begin to kick in and a lot of that new equipment comes on line, which makes workers much more competitive.

And I think Dr. Harris is right. You know, cutting the corporate tax rate does help old investment as well as new investment. But what you really get the bang for your buck is that expensing provision where companies are allowed to go out and expense that new equipment, which makes their workers more productive——

Senator Heinrich. Dr. Harris, what have you seen in the wage data in terms of the impact of this?

Dr. Harris. Just to take that $4,000 calculation by Kevin Hassett, who is Chairman of the CEA, we have a $1.3 trillion corporate tax cut over 10 years. So that is about $130 billion per year. In order to grant each worker a $4,000 on average wage, just multiplying out the number of workers in the economy, you are talking about $600 billion per year.

So what Dr. Hassett suggested was that a $130 billion tax cut on the corporate side would lead to $600 billion on the wage side? It is just implausible. I have not seen——

Senator Heinrich. I am still looking for the worker. I have been asking people at home, you know, who got that $4,000 wage increase, and I am still looking.

Dr. Harris. Well wages on average have not grown since the passage of the tax cut.

Senator Heinrich. Let me ask another question. And we can just go down the line here. I will start with you, Dr. Harris, and then we will just go the other direction.

This bill was not free: $1.9 trillion by one estimate. There are a number of different estimates, but we all recognize it came with a price tag. Now a number of people, including the Speaker of the House, are saying that to pay for our current fiscal situation that we need to cut Social Security. We need to cut Medicare. We need to cut Medicaid. Would each of you support cutting benefits for those three programs?

Dr. Harris. And then we will just go the other way.

Dr. Harris. So in addition to being a scholar who studies taxes, I have also spent much of my career studying retirement. Social Security, in my opinion, is undoubtedly the bedrock of the U.S. retirement system. About half of retirees, as I mentioned in my earlier testimony, depend almost entirely on Social Security. If you cut Social Security by 10 percent, you are making those workers 10 percent worse off. If we cut Social Security, we are asking older workers, or older retirees who cannot plausibly——

Senator Heinrich. I hate to cut you off—I was just asking, could we go a little long on this question, and I will let him finish?

Dr. Harris. I will just be direct. No, I would not. I would worry that cutting Social Security, Medicare, and even Medicaid which supports long-term care, would have disastrous consequences for retirees.

Senator Heinrich. You, sir?

Mr. Hinderaker. Well first of all, I think the best thing to do about our deficit—and I am glad to see that people are concerned about the deficit. There has been too little concern about it, especially from the Democrats, for a long time. So I am glad to see it.

I think the best thing to do about the deficit is to grow the economy at something like a 4 percent rate. That does an enormous amount to protect on the spending side.

Senator Heinrich. Growing the economy is absolutely fantastic for the deficit. Would you support cuts to those three programs?

Mr. Hinderaker. I would not support cuts to Social Security. I would support cuts to Medicare, which is really the one that is breaking the bank. We have got to find a way to restrain the growth in that program.

Senator Heinrich. And Medicaid?

Mr. Hinderaker. Medicaid I think is in the same category with Medicare, but I would be open to study that.

Senator Heinrich. Dr. Dunkelberg.

Dr. Dunkelberg. Well Medicaid is the real threat. And I think if you look at Social Security, it might not be unreasonable to consider a change in the retirement age, or looking at means' testing Social Security. I think Bill Gates might be happy to give his up.

Senator Heinrich. Mr. Hodge.

Mr. Hodge. These programs are promising benefits that are unaffordable. And unless they are reformed, this country faces a tax increase——

Senator Heinrich. So you would actually cut off all three?

Mr. Hodge. We have to reform all of them. And there are different ways that you can go about making them actuarially sound and fiscally sound. But otherwise, we face a tax increase that this country has never faced before, and that will be detrimental—devastating to the economic growth of this country.

Chairman Paulsen. Thank you. I know Senator Klobuchar is on her way, so let me just ask one more question until she gets here.

First of all, one piece of good news is obviously with the growing competitive economy, I know Social Security is on firmer footing with more revenues coming in, with a stronger economy and more payroll tax dollars coming in for the Federal Government.

But, Mr. Hodge, what are your major areas of disagreement with Dr. Harris' testimony? Because you are kind of on opposite ends here. I mean, why are you right—and Dr. Dunkelberg and Mr. Hinderaker you can add something—but just outline some of the perspectives you might have, Mr. Hodge, versus Dr. Harris, because you are at opposite ends on the testimony.

Mr. Hodge. I guess I am on his right today, all kidding aside.

Chairman Paulsen. But why are you right?

Mr. Hodge. No, I think the major disagreement here is on the effects of deficits and crowding out in the economy. Actually, if you look at a lot of the models that the Tax Policy Center, the Wharton, CBO, and the Joint Committee on Taxation, if you line them up to the way that we have estimated or looked at the Tax Cuts and Jobs Act, it is fairly similar.

They show that it is pro-growth. Where we differ is on the effects of the deficit in this, quote, "crowding out" that happens in rising interest rates. We do not see that happening. There is $20 trillion a year worth of savings globally every year, and a little bit of deficit in the United States is not going to crowd out and raise interest rates on a global basis.

So we do not believe that that is actually a proper way to look at this. And so, while they see economic growth from this plan, it gets, quote, "crowded out" by this deficit effect, we don't think that that is a correct way to look at it. And that is why we show much more growth than they do.

Chairman Paulsen. Dr. Dunkelberg and Mr. Hinderaker, you can add something as Senator Klobuchar gets ready.

Dr. Dunkelberg. Sure. I would point out two things, or three things maybe. But obviously it was noted that one of the things that is growing really quickly is the cost of benefits. And so when you go to measure wages, we should really be paying attention to that.

We should also note that employment is growing substantially. Millions of new jobs are created. What was their income before they got the job? So we include them in the wage growth calculation, and we take total wages and divide by the total number of people working, and we get an average wage. Well, gee, it did not go up as much as we hoped. But how about all the people that are in there that were not in there before? We really have to acknowledge that.

And finally, we do know that the government revenues do grow when the economy grows. And so we have got more people to tax.

We have got higher incomes to tax. Government revenue, we have never been able to estimate that very well going forward. It is going to certainly mitigate the deficit issue.

Chairman Paulsen. Mr. Hinderaker, a brief comment?

Mr. Hinderaker. Yes, on this issue of the missing $4,000 in wage increases, in Minnesota, in only six months we have seen significant wage increases, which if you annualize it adds up to $1,200 per year. That is a big chunk of the $4,000 in just six months.

So I would push back on this theory that we are not seeing wage increases. We certainly are in Minnesota.

Senator Paulsen. Senator Klobuchar, you are recognized for five minutes.

Senator Heinrich. I have spent a lot of time talking to a lot of hourly workers. I have yet to find one that even felt like they got a thousand or a twelve hundred dollar raise. I think that flies in the face of real experience out with real working people.

Senator Klobuchar. Okay. Well I can only be here briefly because we have another hearing going on that you might have heard of. So I feel like I am going to start asking you guys about, you know, the *Times* v. *Sullivan*, or precedent versus settled law, but I will try to focus on our topic at hand.

I had one specific thing that I was figuring out during the debate on the tax bill. I will start with you, because I think you know about this, Dr. Harris. It is something I had spoken with Gene Sperling about, who is the former Director of the National Economic Council. And he warned before the tax law was passed that its allowance of a global minimum tax, rather than a country-by-country minimum, will incentivize companies to shift more of their operations overseas. And I think it is probably too soon to know if that has happened, but the idea was that if you do it country-by-country minimum it would not have that kind of incentive. But if you do this global minimum tax, there would be some incentive because you would want to get at the average. And so some of the jobs would move to basically no-tax countries. And I just wondered if you could respond to that.

Dr. Harris. So I agree that it is too early to evaluate the impact of the changes in our system of foreign taxation.

But there is I think legitimate concern that some of the provisions in the TCJA perhaps inadvertently will push domestic activity overseas.

So for the GILTI and for the FDII provisions, those are both based on tangible assets. And so if you are a company and you move your factory overseas with those two particular provisions, you will get a higher tax benefit, all else equal.

Before what we saw in our tax code was that there were incentives to move intangible activity overseas—Apple, tech companies that had IP, and they were basically trading in ideas. The problem with the current system now is that there are provisions that will incent the movement of factories and actual real production.

So I agree that it is too early to tell, but if you just look at the incentive, companies do have an incentive to pick up that factory out of places like Minnesota, and every State in the country, and move it overseas because they get a tax benefit if they do so.

We will be watching that carefully, but right now I think it is a real concern.

Senator Klobuchar. Does anyone else want to comment? No? Okay.

Mr. Hodge, each year Congress' Joint Committee on Taxation releases a list of tax expenditures. Those are deductions, exclusions, you know. And Congress has long talked about broadening the base by reforming these tax expenditures, thereby reducing the complexity of the Tax Code, boosting fairness, reducing the deficit, and that was the over-reaching goal that drove that bipartisan tax reform way back in 1986.

To what extent did the Tax Cuts and Jobs Act broaden the base by eliminating tax expenditures to offset rate reductions?

Mr. Hodge. It did some, but not enough. We would recommend that Congress go much further in eliminating tax expenditures.

We would trade those off for lower rates. We do think that that's the key to economic growth, is broadening the base and lowering rates.

There was a little bit of work done on that, but not enough. There is still far too much junk in the Tax Code, far too much complexity, and it is costing the economy. The more we can rid the Code of those sorts of things, the better.

Senator Klobuchar. Okay. Maybe I will end here with our home State guest, Mr. Hinderaker, welcome. And I had wanted to bring the corporate rate down. I made that clear many times, including during the debate. But I was concerned that it just went too far where it ended up, and you and I will have reasonable disagreement on this. And one of the reasons I was concerned was at every point we went down with $100 billion, and one of the ways that we could have spent maybe one percent, one point of that money was on infrastructure.

And we had a bipartisan bill that was good, that passed a few years ago, that Senator McConnell actually led in the Senate. I was one of the first Democrats to sign on, called the FAS Act, which is a scary name to name any bill in Congress, but it passed and we were able to add some money into infrastructure.

But I think we still are so behind, when we have got the American Society of Civil Engineers' 2013 report card U.S. still at a D+ on overall condition of the Nation's infrastructure. We obviously had issues in Minnesota with the bridge collapse. We put more State money into a number of our projects there. But what are your ideas for funding infrastructure? What do you think we should do? Because now we have gone down to this rate where it is going to be harder to get that kind of funding that I think we need, not just your traditional congestion issues, or jobs from infrastructure, it's just getting goods to market in this colossally intertwined global economy, whether it's locks and dams, or rail, or highways and bridges.

Mr. Hinderaker. Well, Senator, I disagree with the idea that these cuts have created a revenue problem. I think the Federal Government has gotten more than enough revenue.

I think the question is what should the government be doing with that revenue? You mentioned the corporate income tax. We didn't cut it way down. We cut it down to about average. So at least it is not totally noncompetitive. But it still is at about the average range.

I agree with you that infrastructure is something that should be prioritized. And I think in the vast dollars that are being spent by the Federal Government, adequate infrastructure should be a high priority.

So I don't know that we are disagreeing too fundamentally there.

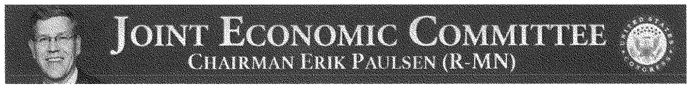
Senator Klobuchar. Okay. Thank you very much. And thank you, Representative Paulsen, and Senator Heinrich.

Chairman Paulsen. Thank you. I want to thank all of our witnesses for being here today. We had a House vote that was called, which is why we lost a few Members during our discussion. But I will remind Members that if they wish to submit questions for the record, the hearing record will remain open for three business days.

And with that, I will adjourn the hearing.

[Whereupon, at 3:23 p.m., Thursday, September 6, 2018, the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD



I call this hearing to order.

Most economists say that it's too soon to know how the Tax Cuts and Jobs Act will affect our economy. I agree with them.

That's because tax reform wasn't designed to give a short-term "sugar rush" to the economy. It was intended to improve the levers that drive economic growth—more work, more capital, and more productivity—so that in the long run, American workers and families enjoy more prosperity and opportunity.

The evidence shows that this is already beginning to happen.

As Federal Reserve Chairman Jerome Powell put it, "The economy is doing very well."

The Bureau of Economic Analysis recently revised upward its estimate of GDP growth to 4.2% in the last quarter.

Survey after survey shows business optimism is surging.

Individual tax relief has allowed people to keep more of their hard-earned money so that it's worth it to work hard, find a job, and keep reaching for that next opportunity.

By investing in individuals and those who employ them, we're putting a downpayment on a more prosperous future for all Americans.

After business reforms became law, companies started to invest in their workers and businesses in ways that lead to a more productive workforce. That, in turn, leads to growing paychecks and higher economic growth in the long run.

This reform fought for American workers by attracting investment here at home and encouraging companies to keep high-value intellectual property in America instead of overseas.

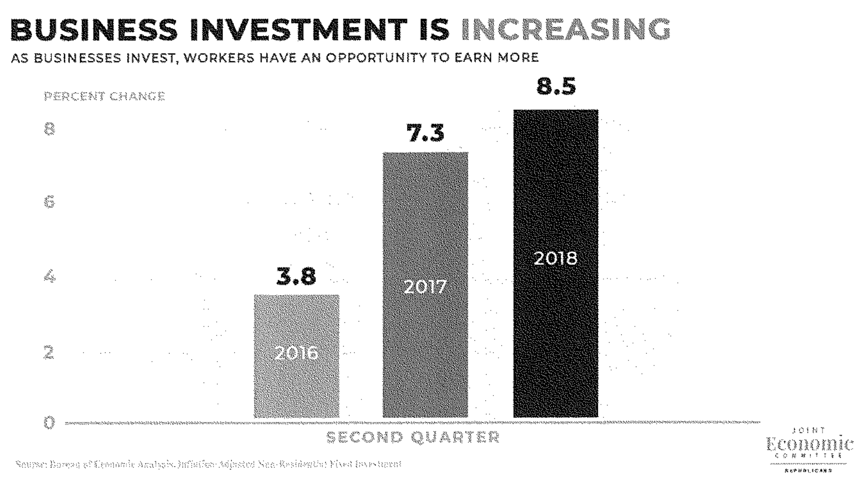
Profits earned in international markets are returning to the U.S. where it can be invested in greater opportunities for our people.

Though we shouldn't base the success of tax reform on what's happening in the short term, we're already seeing positive effects from these long-term incentives to work and invest.

Business investment—which paves the way for future wage and economic growth—is picking up. After all, an employee's wages can only increase following the decision by a business to invest more in its workers and company. We want that to be an easy decision.

Since the Tax Cuts and Jobs Act became law, business investment has outperformed similar periods in 2017 and far exceeded the weak and sometimes negative growth in the final year of the Obama Administration.

This chart comparing second-quarter growth rates shows how much business investment has increased in the last two years compared to the last year of the Obama Administration.



In fact, since tax reform became law, we've seen an average growth rate of 10 percent so far this year. This is great news.

Yes, it will take time for tax reform to have its full effect on investment and wages.

Yet the Congressional Budget Office noticed rising wages in its latest report on Federal revenues. JEC economists also analyzed 21 different measures of wage growth and inflation and 20 of 21 showed real wages rising faster during this Congress and Administration than during the Obama-era recovery.

Small business owners are also seeing benefits, with small business optimism, new hiring, worker pay increases, and investment plans near record highs.

And for those who claim that tax reform only benefits the wealthy, there is great news for the Americans who struggle the most in a weak economy—those with less education, minority workers, and people with disabilities.

Unemployment is at the lowest level since the year 2000, but the untold story is that it is falling faster for these disadvantaged groups than for other groups that tend to do well.

It's also worth noting that the Joint Committee on Taxation found that, during the time individual tax relief from the Tax Cuts and Jobs Act is in effect, the greatest percentage tax cuts will go to those with incomes between $20,000-$50,000 and that millionaires will pay a larger share of the Federal tax burden with tax reform than they would without it.

Tax reform was just a first step. We should continue to improve our tax code to meet the challenges of an ever-changing global economy. But the Tax Cuts and Jobs Act put America on a much stronger economic footing, which will make many of our Nation's challenges easier to tackle.

I look forward to our distinguished panel of witnesses, including one from my home State of Minnesota.

Before I introduce our panel of experts, I now recognize the Ranking Member, Senator Heinrich, for a period of 5 minutes for his opening statement.

PREPARED STATEMENT OF HON. MARTIN HEINRICH, RANKING MEMBER, JOINT ECONOMIC COMMITTEE

Thank you Chairman Paulsen. I agree with you that it's useful to look at the Republican tax law's impacts on the economy, working families, and our Nation's future economic position.

I suspect we will come to very different conclusions.

At best, the Republican tax bill was a massive missed opportunity, squandering $1.9 trillion on tax breaks for those who don't need them at a time our Nation can least afford it.

The bill does little to help working families. Instead, it worsens inequality and burdens the next generation with trillions in additional debt, which could jeopardize vital programs and services families count on.

At a basic level, the law hasn't lived up to Republican promises. The White House and my Republican colleagues promised families a $4,000 a year increase in income.

But that hasn't happened.

In fact, wages adjusted for inflation are actually going down, not up.

As you can see in this chart on wage growth, the average hourly wage for production and nonsupervisory workers—our best measure of the typical worker's take-home pay—was lower in July 2018 than July 2017, after adjusting for inflation.

In other words, wages aren't keeping pace with the cost of living.

That means it's harder for the typical family to buy groceries, pay rent and put gas in the tank.

After decades of wage stagnation—where the median worker's wages have grown by 6.1 percent over the last 38 years—people need a real raise, not empty promises.

The reality is that the Republican tax bill is doing exactly what virtually all mainstream economists and Democrats said it would do. It is delivering the vast majority of its benefits to large corporations and wealthy individuals, while leaving working Americans behind.

Stock buybacks are now at record highs, with Goldman Sachs projecting they will reach $1 trillion by the end of the year.

While buybacks benefit company executives and other wealthy shareholders and investors, they do nothing for half of all Americans who own no stock. And, since foreign investors own 35 percent of U.S. stocks, much of the benefits of the buybacks are flowing overseas.

It's important to remember that each dollar spent on buybacks is a dollar not spent on investing in factories or plants, training, or boosting workers' wages.

We could have gone a different direction.

My Republican colleagues could have joined with Democrats to craft deficit-neutral, pro-growth tax reform.

But, by adding $1.9 trillion to the national debt, the tax law gives Republicans their latest justification to target Social Security, Medicare, and Medicaid.

Just last month, Republican Representative Steve Stivers, the chair of the NRCC, expressed support for turning Medicare into a voucher program.

Republicans are again pushing to cut health care coverage that families receive through Medicaid and go after Medicare and Social Security, which seniors and their families count on.

In my State, more than half of New Mexicans depend on these three programs and the Affordable Care Act to help with health care and living expenses.

Cuts to these programs would have devastating consequences for families who have seen little to no benefit from the tax cuts.

Recent economic projections remind us that any growth bump from the Republican tax cut will be short lived.

So, Republicans will try to take your eyes elsewhere.

Republicans will point to second quarter GDP growth, but will neglect to mention that we have hit higher levels multiple times in this recovery, or that long-term projections are unchanged.

In fact, economists at the San Francisco Fed recently projected that the tax cuts could have zero impact to growth, due to the poor timing of the law.

They'll talk about this years' job growth, but fail to acknowledge that 2018 and 2017 look basically the same as 2016 and 2015. In fact, as this chart on job growth shows, the economy is adding fewer jobs per month since President Trump took over.

Now, Republicans want to make permanent the temporary provisions of the bill—to dole out a second helping of tax breaks.

But doing so would deliver two-thirds of the benefits to the wealthiest 20 percent and add nearly $800 billion more to the debt by 2028.

The Republican tax law was the wrong medicine at the wrong time. The solution is not to take more of it.

I want to thank each of the witnesses for your testimony today and I look forward to a spirited discussion.

TAX FOUNDATION Since 1937

TESTIMONY
September 6, 2018

Written Testimony of
Scott Hodge
President of the Tax Foundation

Before the Joint Economic Committee

"The Positive Economic Growth Effects of the Tax Cuts and Jobs Act"

Chairman Paulsen, Ranking Member Heinrich, and members of the Committee, thank you for the opportunity to speak to you today about the economic benefits we expect to see from the Tax Cuts and Jobs Act.

The Tax Foundation is the nation's oldest organization dedicated to promoting economically sound tax policy at the federal, state, and local levels of government. We are a nonpartisan 501(c)(3) organization.

For 81 years, the Tax Foundation's research has been guided by the immutable principles of sound tax policy which say that taxes should be neutral to economic decision-making; they should be simple, transparent, and stable; and they should not hinder economic growth.

In December, Congress passed a historic tax reform package, which made the U.S. tax code more competitive. The Tax Cuts and Jobs Act is not perfect, but as passed, it is expected to grow the U.S. economy, resulting in a higher level of GDP, higher wages for workers, and more full-time equivalent jobs.

However, economic growth, spurred by tax reform, takes years to occur. In this testimony, I discuss the relationship between taxes and economic growth, the pro-growth impacts of the Tax Cuts and Jobs Act, and its distributional impact. Additionally, I investigate the timing of these changes and whether there is economic evidence of changes thus far.

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and local levels. We are a 501(c)(3) nonprofit organization.

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Why Taxes Affect Economic Growth

To understand how tax policy affects economic growth, we should begin with an understanding of what drives economic growth. Under a neoclassical economic view, the main drivers of economic output are the willingness of people both to work and to deploy capital, such as machines, equipment, factories, etc.[1] The supply of labor and capital is determined by their respective prices.

Taxes play a role in decisions to work and to deploy capital, because taxes affect the return to labor and capital. For example, the corporate income tax rate and cost recovery provisions are important determinants of the cost of capital, which affects how much people are willing to invest in new capital, and in where they will place that new capital. The individual income tax likewise affects how much people are willing to work by creating a wedge between what an individual is paid and what they receive after taxes.

If individuals supply more work, or if businesses supply investments in new equipment or factories, this creates more economic output. Neoclassical economics helps explains this process.

Evidence shows that of the different types of taxes, the corporate income tax is the most harmful for economic growth.[2] One key reason that capital is so sensitive to taxation is because capital is highly mobile. For example, it is relatively easy for a company to move its operations or choose to locate its next investment in a lower-tax jurisdiction, but it is more difficult for a worker to move his or her family to get a lower tax bill. Capital is, therefore, more responsive to tax changes; lowering the corporate income tax rate reduces the amount of economic harm it causes.

A common misunderstanding is that corporations bear the cost of the corporate income tax. However, a growing body of economic literature indicates that the true burden of the corporate income is split between workers through lower wages and owners of the corporation.[3] As capital moves away in response to high statutory corporate income tax rates, productivity and wages for the relatively immobile workers fall. Empirical studies show that labor bears about half of the burden of the corporate income tax.[4]

To understand why the lower corporate tax rate drives growth in capital stock, wages, jobs, and the overall size of the economy, it is important to understand how the corporate income tax rate affects economic decisions. When firms think about making an investment in a new capital good, like a piece of equipment, they add up all the costs of doing so, including taxes, and weigh those costs against the expected revenue the capital will generate. Projects where the costs exceed the benefits are not undertaken. All else constant, a higher corporate income tax could prevent a project from being undertaken.

1 Scott A. Hodge, "Dynamic Scoring Made Simple," Tax Foundation, Feb. 11, 2015, https://taxfoundation.org/dynamic-scoring-made-simple/.

2 Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys, and Laura Vartia, "Tax and Economic Growth," OECD, July 11, 2008, https://www.oecd.org/tax/tax-policy/41000592.pdf. See also William McBride, "What Is the Evidence on Taxes and Growth?" Tax Foundation, Dec. 18, 2012, https://taxfoundation.org/what-evidence-taxes-and-growth.

3 Scott A. Hodge, "The Corporate Income Tax is Most Harmful for Growth and Wages," Tax Foundation, Aug. 15, 2016, https://taxfoundation.org/corporate-income-tax-most-harmful-growth-and-wages/.

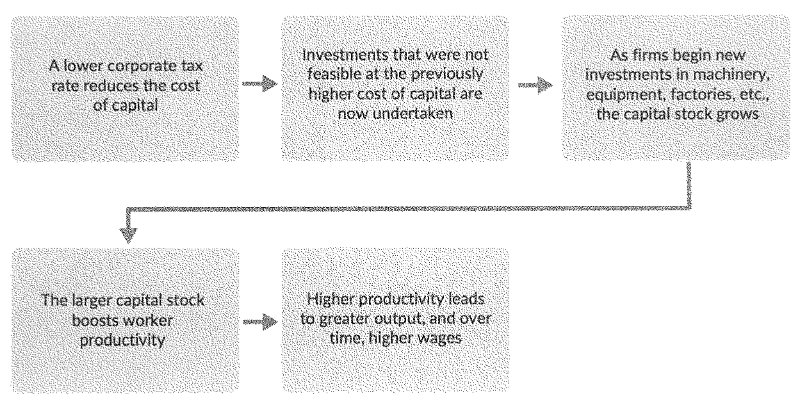
4 Stephen Entin, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation, October 2017, https://files.taxfoundation.org/20171102152936/Tax-Foundation-SR2381.pdf.

Therefore, the higher the tax, the higher the cost of capital, the less capital that can be created and employed.[5] So, a higher corporate income tax rate reduces the long-run capital stock and reduces the long-run size of the economy.[6] Conversely, lowering the corporate income tax incentivizes new investment as previously unprofitable projects are now worthwhile, leading to an increase of the capital stock.

This long-run increase in the capital stock is not just beneficial for businesses. Workers benefit from this effect as well. Capital formation, which results from investment, is the major force for raising incomes across the board.[7] More capital for workers boosts productivity, and productivity is a large determinant of wages and other forms of compensation. This happens because, as businesses invest in additional capital, the demand for labor to work with the capital rises, and wages rise too.[8] Figure 1 below describes this process.

FIGURE 1

How Lower Business Tax Rates Raise Worker Pay



5 Stephen J. Entin, "Disentangling CAP Arguments against Tax Cuts for Capital Formation: Part 2," Tax Foundation, Nov. 17, 2015, https://taxfoundation.org/disentangling-cap-arguments-against-tax-cuts-capital-formation-part-2.

6 Alan Cole, "Fixing the Corporate Income Tax," Tax Foundation, Feb. 4, 2016, https://taxfoundation.org/fixing-corporate-income-tax.

7 Stephen J. Entin, "Disentangling CAP Arguments against Tax Cuts for Capital Formation: Part 2."

8 Ibid.

Economic Impact of the Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act represents a dramatic overhaul of the U.S. tax code, and the results of our Taxes and Growth (TAG) Macroeconomic Tax Model indicate that the new law is pro-growth.

Just nine short months ago, the major provisions of the Tax Cuts and Jobs Act took effect. The law reduced tax rates for both businesses and individuals, limited major deductions, and created a new set of rules for companies that earn income overseas.

In the short run, the tax changes will result in a small, demand-side response as individuals' after-tax income increases. Individuals will have lower tax burdens, which results in an increase in spending power, but these results are not the real drivers of long-run economic growth.

The Tax Cuts and Jobs Act was designed to do more; to improve incentives in the economy, encouraging taxpayers to work more, save more, and invest more over the long term. Lowering taxes on capital and labor is expected to boost productivity, wages, and the size of the economy.

It is unrealistic to expect fiscal policy changes, like the Tax Cuts and Jobs Act, to produce immediate results. Politics demand results now and spectators are eager to pass an early judgment of the new law, but unfortunately, tax reform and economic growth do not do their work within a news cycle. In fact, the current debate resembles a long car ride with your kids. An hour into the ride they kick the back of your seat and demand to know, "Are we there yet?" But these things take time and patience.

Since the enactment of the Tax Cuts and Jobs Act, economists across the spectrum have looked through the data and anecdotes to identify whether the anticipated economic gains are coming to fruition and how the benefits could flow through to workers and shareholders. But looking at snapshots of data is not a useful exercise; there are many conflating factors to contend with, and nine months is simply not enough time to detect long-run economic changes.

Permanent Provisions

Using a neoclassical framework, as described above, the Tax Foundation has developed a General Equilibrium Model, called the Taxes and Growth model, to simulate the effects of tax policies on the economy and on government revenues and budgets.[9] The model can produce both conventional and dynamic revenue estimates of tax policy. The model can also produce estimates of how policies impact measures of economic performance such as GDP, wages, and employment. The Taxes and Growth model can also produce estimates of how different tax policies impact the distribution of the federal tax burden on both a conventional and dynamic basis.

The Tax Foundation Taxes and Growth model estimates that the total effect of the new tax law will be a 1.7 percent larger economy, leading to 1.5 percent higher wages, a 4.8 percent larger capital stock, and 339,000 additional full-time equivalent jobs in the long run.[10] We anticipate these benefits will occur because the Tax Cuts and Jobs Act improved major incentives in the economy, but it will take time for taxpayers to respond to those improved incentives, and for those responses to boost wages and economic growth.

Table 1: Economic Impact of the Tax Cuts and Jobs Act

Change in long-run GDP	1.7%
Change in long-run capital stock	4.8%
Change in long-run wage rate	1.5%
Change in long-run full-time equivalent jobs	339,000

Source: Tax Foundation Taxes and Growth Model, November 2017.

This increase in long-run economic growth is driven by the now lower corporate income tax rate, which decreased from 35 percent to 21 percent.[11] Prior to the Tax Cuts and Jobs Act, the United States' high statutory corporate tax rate stood out among rates worldwide. Among countries in the Organisation for Economic Co-operation and Development (OECD), the U.S. combined corporate income tax rate was the highest.[12] Now, post-tax reform, the rate is close to average.

9 Tax Foundation staff, "The Tax Foundation's Taxes and Growth Model," Tax Foundation, April 11, 2018, https://taxfoundation.org/overview-tax-foundations-taxes-growth-model/.

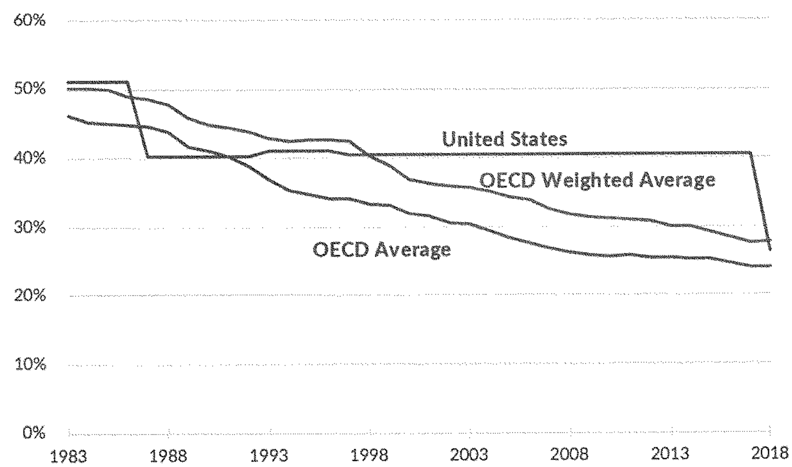
10 Tax Foundation staff, "Preliminary Details and Analysis of the Tax Cuts and Jobs Act," Dec. 18, 2017, https://taxfoundation.org/final-tax-cuts-and-jobs-act-details-analysis/.

11 Erica York, "The Benefits of Cutting the Corporate Income Tax Rate," Tax Foundation, Aug. 14, 2018, https://taxfoundation.org/benefits-cutting-corporate-income-tax-rate/.

12 Kyle Pomerleau, "The United States' Corporate Income Tax Rate is Now More in Line with Those Levied by Other Major Nations," Tax Foundation, Feb. 12, 2018, https://taxfoundation.org/us-corporate-income-tax-more-competitive/.

FIGURE 2.

Top Corporate Income Tax Rate, United States vs. OECD, 1983-2018



Source: CBT Tax Database, OECD Statistics, USDA ERS International Macroeconomic Data Set, and Author's Calculations

As discussed previously, the lower corporate income tax rate lowers the cost of capital, which encourages new investments in the United States. As additional investment grows the capital stock, the demand for more workers to work with the new capital will increase, leading to higher productivity, output, employment, and wages over time. This is not a process that happens overnight; companies will need to plan and then build new investments, workers will then use those new investments and become more productive, and over time this will bid up wages and increase output. Realistically, it will take years to fully assess the economic impact of the Tax Cuts and Jobs Act. And the changes won't be as obvious as bonus checks or new projects with "Tax Cuts and Jobs Act" on the memo line. It is likely that workers will see slightly higher pay increases than they otherwise would have as productivity and the economy grow faster.

Temporary Provisions

However, the long-run impacts of the law are muted. The Tax Cuts and Jobs Act used a Senate budget process known as reconciliation, which required that the law may not impact the deficit after the first ten years. As such, major portions of the Tax Cuts and Jobs Act are set to phase out or expire. These temporary provisions frontload some of the anticipated economic growth, but because they expire, they do not contribute to the long-run impact of the new tax law. Ideally, Congress would work to make several of these provisions permanent to maximize economic growth.

100 Percent Bonus Depreciation

The Tax Cuts and Jobs Act made significant progress in improving the cost recovery treatment of business investment by enacting 100 percent bonus depreciation. Under the U.S. tax code, businesses can generally deduct their ordinary business costs when figuring their income for tax purposes. However, this is not always the case for the costs of capital investments, such as when businesses purchase equipment, machinery, and buildings. Typically, when businesses incur these sorts of costs, they must deduct them over several years according to preset depreciation schedules instead of deducting them immediately in the year the investment occurs.[13]

Delaying deductions means the present value of the write-offs (adjusted for inflation and the time value of money) is worth less than the original cost, sometimes worth much less. Delayed deductions increase the cost of making an investment, which results in less capital formation, lower productivity and wages, and less output.[14]

The new 100 percent bonus depreciation provision allows businesses to immediately deduct the full cost of short-lived assets such as machinery and equipment, removing the tax code's bias against these specific capital investments.

The provision is scheduled to be in effect for five years before it begins gradually phasing out at the end of 2022. Beginning in 2023, the provision would be reduced by 20 percentage points each year, for example, dropping to 80 percent in 2023, 60 percent in 2024, and so on until it expires entirely at the end of 2026.[15]

The temporary nature of the provision will incentivize businesses to make their investments sooner, while they can deduct the full cost, rather than later, when they must take depreciation deductions over longer periods. Thus, the provision will pull some investments forward, leading to faster growth in earlier years that slows back down as the provision expires in later years.[16]

On a permanent basis, 100 percent bonus depreciation would generate long-run economic growth.

Table 2. The Long-Run Impact of Making the Tax Cuts and Jobs Act's 100 Percent Bonus Depreciation Provision Permanent

GDP	+0.9%
Wage Rate	+0.8%
Private Business Capital Stock	+2.2%
FTE Jobs	172,300

Source: Tax Foundation Taxes and Growth Model, April 2018

13 Scott Greenberg, "What is Depreciation, and Why Was it Mentioned in Sunday Night's Debate?" Tax Foundation, Oct. 10, 2016, https://taxfoundation.org/what-depreciation-and-why-was-it-mentioned-sunday-night-s-debate/.

14 Ibid.

15 Scott Greenberg, "Tax Reform Isn't Done," Tax Foundation, March 8, 2018, https://taxfoundation.org/tax-reform-isnt-done/.

16 Kyle Pomerleau, "Economic and Budgetary Impact of Temporary Expensing," Tax Foundation, Oct. 4, 2017, https://taxfoundation.org/economic-budgetary-impact-temporary-expensing/.

The Taxes and Growth model estimates that making the 100 percent bonus depreciation provision in the Tax Cuts and Jobs Act permanent would increase the size of the capital stock by 2.2 percent and long-run GDP by 0.9 percent; the larger economy would result in a 0.8 percent increase in wages and 172,300 full-time equivalent jobs.

Individual Income Tax Provisions

The Tax Cuts and Jobs Act significantly lowered individual income tax rates and made aspects of the individual income tax code simpler primarily by reducing the attractiveness of itemizing deductions. However, these individual tax code provisions are all scheduled to expire at the end of 2025.

Some of the most prominent changes in the Tax Cuts and Jobs Act are: the top income tax bracket rate went from 39.6 percent to 37 percent and the rates for other brackets were lowered too; the standard deduction was doubled; both the state and local tax deduction and the mortgage interest deduction were capped; the personal exemption was eliminated; and the child tax credit was doubled. The outcome of these changes has been to lower the tax rate on labor and to push filers towards choosing the standard deduction instead of itemizing, which means the process of tax filing will be much simpler.

For example, the Internal Revenue Service estimates the average time to complete an individual tax return will drop by 4 to 7 percent. Converting this to dollar terms, we estimate compliance savings could range from $3.1 billion to $5.4 billion annually.[17]

Though these tax cuts do not result in long-term economic growth because they expire, they do result in some short-term dynamic growth and revenue by increasing the incentives to work.

If the current iteration of Tax Cuts and Jobs Act goes unchanged and these parts of the bill are allowed to expire, then households will see higher tax rates and a more complicated filing system when they file their taxes in 2026. In response, individuals would reduce their labor force participation and hours worked; the temporary lowering in individual income taxes does not change long-run incentives, explaining why these temporary individual rate cuts do not add to the long-run size of the economy.

Making the Tax Cuts and Jobs Act's expiring individual tax code changes permanent would result in a larger economy in the long run by permanently increasing these incentives to work and invest.[18]

According to the Tax Foundation Taxes and Growth model, making these provisions permanent would have a small, positive impact on the economy during the 2019 to 2028 budget window. The growth impact of expansion is limited, due to the extension's timing. The provisions are currently in effect through 2025, meaning that only three years of extension are being captured in the budget window.

17 Erica York and Alex Muresianu, "Reviewing Different Methods of Calculating Tax Compliance Costs," Tax Foundation, Aug. 21, 2018, https://taxfoundation.org/different-methods-calculating-tax-compliance-costs/.

18 The extension of the Section 199A pass-through deduction would be pro-growth, but arguably, reforms to the deduction's structure would be more beneficial. For more information, see Scott Greenberg and Nicole Kaeding, "Reforming the Pass-Through Deduction," Tax Foundation, June 21, 2018, https://taxfoundation.org/reforming-pass-through-deduction-199a.

The economic benefits from making these provisions permanent are found in the long run, as the impacts of tax reform take several years to be fully realized. In the long run, making all individual tax provisions permanent will lead to 2.2 percent higher long-run GDP, 0.9 percent higher wages, and 1.5 million more full-time equivalent jobs. However, it would reduce federal revenues by $166 billion annually.

Table 3. The Long-Run Impact of Making the Tax Cuts and Jobs Act Individual Provisions Permanent

Long-Run GDP	+2.2%
Wages	+0.9%
Jobs	+1.5 million

Source: Tax Foundation Taxes and Growth Model, April 2018

Section 199A Pass-Through Deduction

The Tax Cuts and Jobs Act created a deduction for households with income from pass-through businesses—companies such as partnerships, S corporations, and sole proprietorships, which are not subject to the corporate income tax.

The pass-through deduction allows taxpayers to exclude up to 20 percent of their pass-through business income from federal income tax. The deduction is subject to several limits, which are intended to prevent abuse. These limits are based on the economic sector of each business, the amount of business wages paid, and the original cost of business property. These limits only apply to upper-income taxpayers.

The design of the pass-through deduction leaves room for improvement. The rules for claiming the deduction are relatively complex and will arbitrarily favor certain economic activities over others. Meanwhile, it is unlikely that the current limits on the deduction will be sufficient to prevent abuse. Finally, several features of the provision's design will diminish its economic effect. The pass-through deduction, as currently written, will no longer be available to households beginning in 2026. The extension of the Section 199A pass-through deduction would be pro-growth, but arguably, reforms to the deduction's structure would be more beneficial.

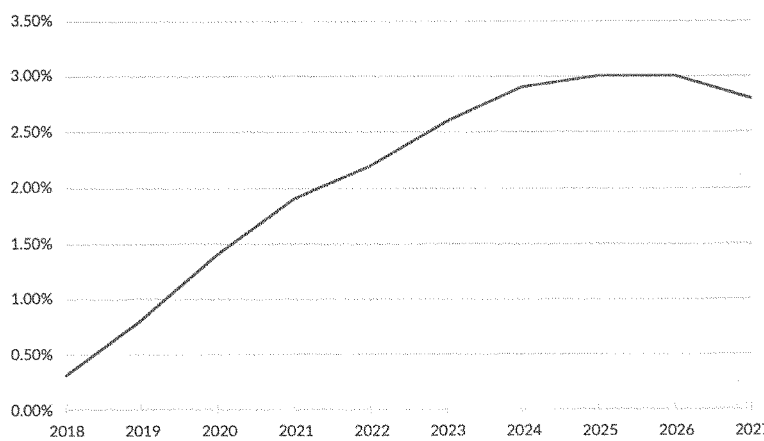
Growth Impacts during the Next Decade

The Taxes and Growth Model is also able to model the combined impacts of these temporary and permanent provisions over the next decade. The Tax Foundation model projects that the Tax Cuts and Jobs Act would boost the size of the economy over the next decade. In the first few years, the economic impact will be modest as companies begin to invest more, building the capital stock. In 2018, we project the economy to be 0.3 percent over baseline and by 2020, it will be 1.4 percent over baseline. By 2025, the economy will be 3 percent over baseline—its highest point over the next decade. In 2026, when the individual provisions expire, and 100 percent bonus depreciation has fully phased out, the size of the economy will stop growing in excess of baseline and begin to shrink.

By 2027, the size of the economy will be 2.8 percent larger than it otherwise would have been. On average, GDP will be about 2 percent above baseline between 2018 and 2027. By 2027, GDP will be $560 billion[19] higher than it otherwise would have been. Additionally, by 2027, GDP will have increased by a cumulative $5.3 trillion over the budget window.

FIGURE 3.

10-Year Economic Impact, Percent Change in Level of GDP



Source: Tax Foundation Taxes and Growth Model, April 2018

The Distributional Impact

The impact of the new law on after-tax incomes of families is just as important as the broader macroeconomic benefits, and in fact, they go hand in hand. Improved incentives to work and to invest are beneficial policies in terms of the size of the economy as well as the size of after-tax incomes. Analyzing the distributional impact of the Tax Cuts and Jobs Act on both a conventional basis and a dynamic basis to account for the growing economy helps provide a clearer picture of how the provisions affect household incomes over the next decade.

The effect of lower tax liabilities from the individual income tax cuts is immediate. On a conventional basis, for example, after-tax income of taxpayers in the middle-income quintile will be 1.6 percent higher in 2018.[20] This is due to the immediate lowering of individual income tax liabilities. On the other hand, the increase in pretax income, due to the projected larger economy, takes time to

19 2018 dollars

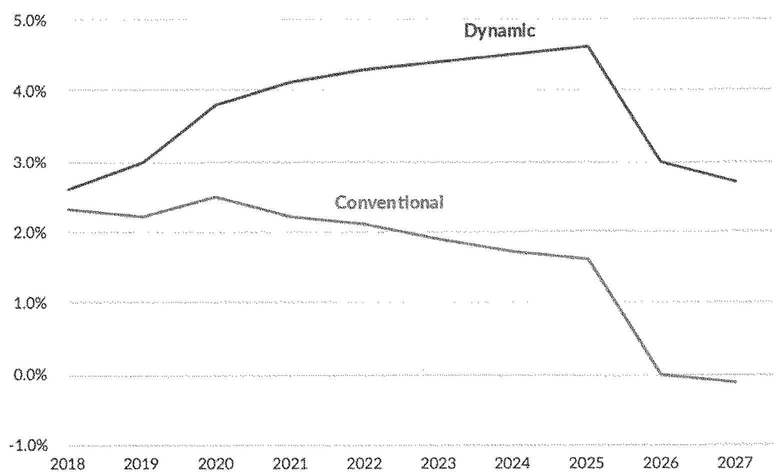
20 Huaqun Li and Kyle Pomerleau, "The Distributional Impact of the Tax Cuts and Jobs Act over the Next Decade," Tax Foundation, June 28, 2018, https://taxfoundation.org/the-distributional-impact-of-the-tax-cuts-and-jobs-act-over-the-next-decade/.

materialize. For this reason, in the first few years of the tax cuts, we project that dynamic increases in after-tax incomes are only modestly higher than on a conventional basis.

But by 2022, for example, more of the economic effects of the Tax Cuts and Jobs Act will have phased in. As a result, we project that dynamic after-tax incomes would increase by 4.3 percent in 2022, compared to the 2.1 percent increase in after-tax income on a conventional basis.

FIGURE 4.

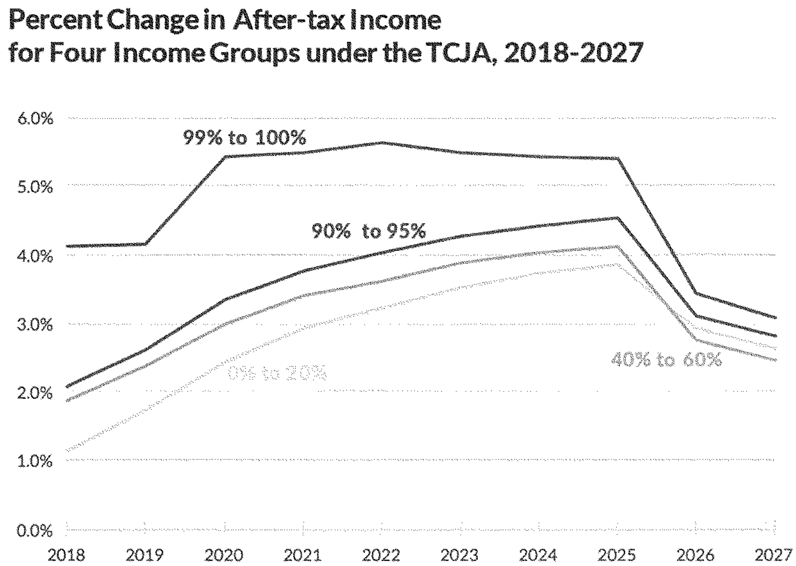
Change in After-Tax Income, All Taxpayers, All Provisions



Source: Tax Foundation Taxes and Growth Model, April 2018

By 2025, we project after-tax incomes to be meaningfully higher on a dynamic basis than on a conventional basis. In 2025, taxpayer after-tax income peaks at 4.6 percent above baseline for all taxpayers. At this point, we project that GDP will be at its highest point during the decade at about 3 percent over baseline. After-tax income for the bottom 80 percent of taxpayers (those in the bottom four quintiles) will increase by between 3.7 percent and 4.2 percent.

FIGURE 5.



Source: Tax Foundation Taxes and Growth Model, April 2018

Even after the expiration of the individual income tax cuts in 2026 and 2027, after-tax income remains above pre-Tax Cuts and Jobs Act levels, when considering economic growth. In 2027, after the major individual provisions have expired, after-tax income for all taxpayers will be 2.7 percent higher than otherwise. This increase in after-tax income will be due entirely to higher pretax incomes, through economic growth. Tax liability will be slightly higher in 2027 due to the expiration of the individual income tax cuts and the adoption of Chained CPI as an inflation measure.

We project the economy will be about 2.8 percent larger than it otherwise would have been in the absence of the Tax Cuts and Jobs Act in 2027.

Overall, the after-tax incomes of taxpayers in most income groups will steadily rise over the next decade on a dynamic basis. Low-, middle-, and upper-middle-income taxpayers will see their after-tax income steadily rise over the decade until 2025. After most individual provisions expire, in both 2026 and 2027, after-tax incomes will still be higher than they otherwise would have been, on a dynamic basis.

Economic Evidence of the Success of the Tax Cuts and Jobs Act

As noted numerous times already, the economic impact of the Tax Cuts and Jobs Act will take years to fully materialize. Therefore, it is difficult to point to any concrete evidence, as of yet, that an acceleration of economic growth is occurring. Similarly, short-term economic data is noisy; margins of error within the data make trend analysis difficult. Nor does a short-term snapshot indicate the direction of long-run economic trends.[21]

Furthermore, the challenge to any economic analysis is separating out any economic changes occurring simultaneously. For example, since the passage of the Tax Cuts and Jobs Act, the Trump administration has accelerated the imposition of tariffs on imported goods from China and other countries. Erecting trade barriers could counteract the benefits of tax reform, muting any proposed growth.

The Tax Foundation Taxes and Growth Model can also estimate the impact of the tariffs proposed by the United States and its trading partners. If all the tariffs proposed by the U.S. and its trading partner were enacted, the jobs impact to the U.S. economy would outweigh that of the Tax Cuts and Jobs Act.[22]

Table 5. Total Impact of Enacted and Announced Tariffs

Long-run GDP	-0.60%
GDP (Billions of 2018 $)	-$150.60
Wages	-0.38%
FTE Jobs	-466,899

Source: Tax Foundation Taxes and Growth Model, April 2018

Thus, it is difficult to say with certainty if any economic results seen since the beginning of 2018 are due to tax reform.

21 Erica York, "Bureau of Economic Analysis Releases Q2 2018 GDP Estimate," Tax Foundation, July 27, 2018, https://taxfoundation.org/bureau-economic-analysis-releases-q2-2018-gdp-estimate/.

22 Erica York and Kyle Pomerleau, "Tracking the Economic Impact of U.S. Tariffs and Retaliatory Actions," Tax Foundation, June 22, 2018, https://taxfoundation.org/tracker-economic-impact-tariffs/.

Conclusion

The Tax Cuts and Jobs Act improved incentives to work and to invest, which are the factors that drive economic growth. This is why we anticipate the new law to have a positive, long-run effect on the economy.

The Tax Foundation Taxes and Growth model estimates that the total effect of the new tax law will be a 1.7 percent larger economy, leading to 1.5 percent higher wages, a 4.8 percent larger capital stock, and 339,000 additional full-time equivalent jobs.

These are not changes that happen overnight, but changes that will take years to manifest.
It is tempting to keep asking that question, "Are we there yet?" The new law improved the competitiveness of U.S. businesses and increased incentives to work and invest in the United States, but these changes do not occur instantaneously. Therefore, it is imperative that we maintain patience and wait for this legislative achievement to boost economic output and wages, and avoid needless speedbumps along the way such as tariffs.

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Statement for the Record of Dr. William C. Dunkelberg

Chief Economist

NFIB Small Business Research Center

Before the

Joint Economic Committee

United States Congress

The Positive Economic Growth Effects of the Tax Cuts and Jobs Act

September 6, 2018

National Federation of Independent Business (NFIB)

1201 F Street, NW Suite 200

Washington, DC 20004

Chairman Paulsen, Ranking Member Heinrich, and members of the Joint Economic Committee:

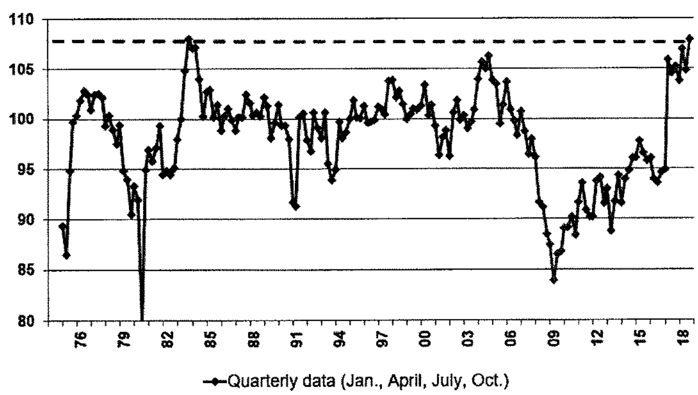
Thank you for the opportunity to discuss with you the *Tax Cuts and Jobs Act* (TCJA) and its impact on the small business sector of our economy. Small business is "big" in the U.S. economy, producing nearly half of our private sector Gross Domestic Product and employing nearly half of our private sector workforce. Small business is the "R&D" for the U.S. economy where entrepreneurs try out their new ideas and inventions and test them in the market place. Profits are the signal that resources are being productively utilized, and those profits provide the capital for expansion as well as attract competitors.

For 45 years, NFIB has surveyed a sample of its hundreds of thousands of member firms and, based on their responses, produced the now well-known *Index of Small Business Optimism*. The record high for the Index occurred in July 1983, the beginning of an expansion that lasted until 1991. That record was nearly eclipsed last month when the Index reached 107.9. The 45 year average of the Index is 98. In October 2016, the Index was 94.9, three points below the average. The same reading was posted in the days before the election.[1] After the 2016 election results were known, the Index averaged 102 for the balance of November, then rose to 105.8 in December and has averaged over 105 since then, culminating in the 107.9 reading in July. "Main Street" is on fire, making a significant contribution to the growth in output and new jobs in the economy.

[1] NFIB mails 10,000 questionnaires on the first day of each month to a random sample of its members. Responses come back over the entire month and are accumulated on the last day to produce the data set used in the monthly Small Business Economic Trends report. At any point in a month, the responses accumulated to date can be accessed and used in analyses producing "before" and "after" measures surrounding an event.

Small Business Optimism Index

Based on Ten Survey Indicators
(Seasonally Adjusted 1986=100)



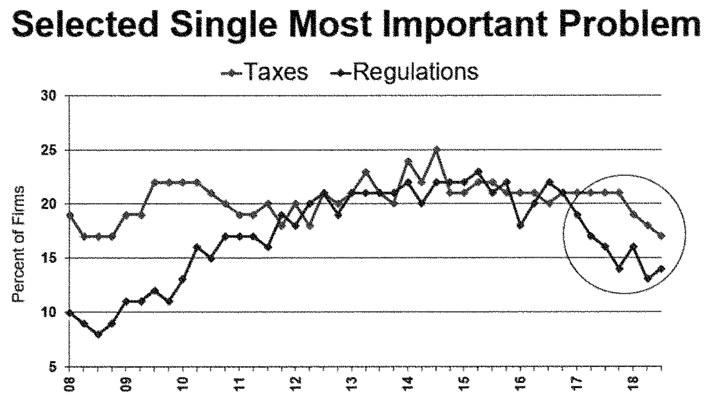
From 2009 - 2017, an average 21 percent of NFIB owners indicated that taxes were their most important business problem followed by the cost of regulations, essentially another tax. Since January, the concern about taxes has fallen to as low as 13 percent in March 2018. NFIB's 2016 *Small Business Problems and Priorities* survey found that five of the top 10 most severe problems facing small business owners were tax-related. "Federal Taxes on Business Income" led the field, ranking third out of 75 problems with 29 percent finding it a critical problem in operating their business. Hope for tax relief surged with the election of President Trump, as the Optimism Index suggested.

Talking about helping small businesses is a popular topic at election time, but this time Congress delivered through the passage of the TCJA. The legal form of small businesses varies substantially, and this has always presented tax issues, especially for passthrough entities. Section 199A, recently clarified in proposed Treasury rules, addressed the passthrough question directly, allowing the vast majority of small businesses a 20 percent deduction on qualified business income. There are 23.5 million small businesses, and 23 million of them have a net income of $250,000 or less.[2] These firms will indeed benefit from the new tax law.

The TCJA has made a significant contribution to the growth of the economy, in terms of improving the bottom lines of small firms but also changing the metrics about the future value of investments. Plans to make capital investments have sustained historical high levels since December 2016, buoyed by strong profit growth which reached a 45-year record high in May, and the prospects of continued strong sales. With elevated capital

[2] https://www.treasury.gov/resource-center/tax-policy/Pages/otapaper_tech.aspx
U.S. Department of the Treasury, OTA Technical Paper #4, November 2016.

spending plans, the payoff is showing up in increased reports of real capital investment. In November 2016, 55 percent of small business owners reported a recent capital outlay. In February this year, 66 percent reported outlays. Inventory investment plans are also strong, an important contributor to GDP growth.



From February through May of 2018 we asked NFIB members what they expected from the new tax code and what they planned to do with any expected tax gains. Three-fourths believed the new tax law would positively impact their business, 22 percent anticipated it will have no impact, and 3 percent a negative impact. Almost half (47 percent) of small business owners who expect to pay less in taxes next year plan to increase business investments with their tax savings, and 44 percent plan to increase employee compensation. Forty percent plan to pay down debt obligations as well, and 32 percent plan to retain the funds freed up as higher earnings available to support business growth. Twenty-seven percent plan to hire an additional employee, although it is becoming more difficult to find qualified applicants.

It is now clear that the optimism surge in late 2016 has translated into stronger economic growth, more output, and more jobs, supported by the new tax law but also by reduced regulatory burdens. Both policy shifts have bolstered sales growth driven by strong consumer sentiment and demand, and optimism that the future will bring even more reductions in the scope of government at all levels: federal, state, and local. The new tax law is a significant step forward in easing one of the main concerns of small business owners: the impact of federal taxes on business income. For long term growth in the small business sector, NFIB strongly urges Congress to make these provisions permanent so that increasing uncertainty over future changes to the tax code do not erode the law's benefits.

Small Business Introduction to the Tax Cuts and Jobs Act: Part 1

May 2018

Executive Summary

- Over three-quarters (76 percent) of small business owners believe the current business climate is heading in a positive direction (Q#4).

- The vast majority (87 percent) percent of small business owners think the new tax law will have a positive impact on the general economy. Just 4 percent believe it will have a negative impact and 9 percent think it will have no significant impact (Q#14).

- Three-fourths (75 percent) of small business owners believe the tax law will positively impact their business, 22 percent anticipate it will have no impact, and 3 percent a negative impact (Q#12).

- While small business owners are enthusiastic about the law generally, many of the details are still unfamiliar to them. Almost one-in-four (24 percent) percent of small business owners are not at all familiar with the new tax law (Q#7).

- Half of small business owners with some familiarity about the law obtained their most useful information from their tax preparer or advisor, another 28 percent from the general news media (Q#8).

- Over half (51 percent) of small business owners expect to pay less in federal income taxes next year, 7 percent expect to pay more, and 37 percent about the same (Q#15).

- Almost half (47 percent) of small business owners who expect to pay less in taxes next year plan to increase business investments with their tax saving (Q#15a5) and 44 percent plan to increase employee compensation (Q#15a6). Another 40 percent of small business owners plan to pay down debt obligations (Q#15a7), 32 percent plan to retain the funds freed up as higher earnings available to support business growth (Q#15a4), and 27 percent plan to hire an additional employee (Q#15a3).

- Over half (55 percent) say that the creation of Section 199A, allowing for up to a 20 percent small business income tax deduction, is "very important" with another 29 percent "somewhat important" (Q#20B).

- Forty-five percent of small business owners say that changes to the personal income tax brackets and rates are "very important" to them and their business, 40 percent say "somewhat important" (Q#20A).

Introduction

The *Tax Cuts and Jobs Act* (TCJA) was signed into law December 22, 2017. The new law is the most comprehensive tax rewrite in over three decades. It offers significant tax relief to many small business owners. Small business is a very diverse sector of the economy, consisting of over five million employer firms with fewer than 20 employees, and about 5.7 million with fewer than 500 employees. In addition, the small business sector includes about 23 million nonemployer firms operating in the economy with varying degrees of activity levels. The NFIB's 2016 *Small Business Problems and Priorities* survey found that five of the top 10 most severe problems facing small business owners are tax related.[3] The most severe is "Federal Taxes on Business Income" which ranks third out of 75 problems with 29 percent of small business owners finding it a *critical* problem in operating their business, not surprising since profits are the major source of capital for firm growth and expansion.

The frustration level associated with tax related costs and compliance is immense. The new tax law will help ease some of these problems for most small businesses, some more significantly than others. NFIB's *Small Business Economic Trends* survey highlights small business owners' enthusiasm for the new tax law as near record optimism levels were achieved in the months following the law's passage.[4] Taxes historically received the most votes as the single most important business problem since 1982, but fell to only 13 percent in March, the lowest reading in 35 years.[5]

This survey provides a benchmark from which to measure future surveys' results. Most small business owners are still learning about how the law will affect them and their business as the impact depends on their form of business and detailed IRS interpretations that are still being developed. And the looming uncertainties with many tax provisions, including the individual tax rates and Section 199A, expiring at the end of 2025 will continue to affect businesses differently. Incorporated businesses have a clearer path as the corporate tax rates were permanently consolidated to 21 percent and the corporate alternative minimum tax was permanently repealed. Congress chose not to make the provisions for "pass through" businesses permanent.

Legal Structure of Small Businesses

Small businesses fall into one of five legal structure categories: sole proprietorship, partnership, LLC, S corporation, and C corporation. The S corporation is the most common legal form of business for small business owners. Forty-two percent of small businesses are structured as an S corporation (Q#2). Twenty percent of small

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[3] *Small Business Problems and Priorities*, Holly Wade, NFIB Research Center, 2016. www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf

[4] *NFIB Small Business Economic Trends*, (ids.) William C Dunkelberg and Holly Wade, NFIB Research Center, series. www.nfib.com/sboi

[5] The historic high survey reading for taxes as the Single Most Important Problem is 32 percent reached in February 1997, the average is 22 percent.

businesses are structured as an LLC, 19 percent as sole proprietorship, and 17 percent as a C corporation. Only 3 percent of small businesses are structured as a partnership.

Small businesses are generally structured as a C corporation for one (or a combination) of three main reasons: tax rate, liability, and legacy. Tax rate is the main reason for using C corporation status for 33 percent of small business owners (Q#2a). Business income for all legal forms of business other than C corporations is treated as personal income and taxed on the owners' individual income tax returns. C corporations are taxed at the 21 percent corporate rate, a rate the new law consolidated from a more progressive, graduated rate structure. Thirty-one percent separately cited liability and legacy advantages as the main reason for their C corporation structure. The five legal forms provide varying degrees of protection for personal assets in the event of a liability suit with larger small businesses generally requiring stronger liability protection.

The new tax law will affect owners differently depending on the legal structure of the business. During the tax reform debate, there was a lot of discussion about whether proposed tax code changes would increase the rate of business owners changing the legal structure of their business. But for now, very few small business owners plan to change their business's legal structure over the next 1 – 3 years in response to the new tax law. Only 4 percent plan to do so with 83 percent planning no change (Q#6). Thirteen percent of small business owners are not sure whether they will change their business's legal structure. Tax rate purposes is the main reason for wanting to switch (49 percent), followed by liability protection (22 percent) (Q#6b).

The number of businesses owned also affects the cost and complexity of a owners' federal tax filing. While most small business owners (66 percent) own one business (Q#26), another 22 percent own two businesses. Twelve percent own three or more. Owners of larger businesses tend to own more of them.

Familiarity with TCJA

The TCJA is a substantial overhaul of the tax code. The IRS and Treasury are still in the process of providing guidance and promulgating regulations for provisions within the law. And while small business owners are enthusiastic about the law generally, many of the details are still unfamiliar to them. Over half of small business owners (57 percent) are not too familiar or not at all familiar with the new law (Q#7). Thirty-eight (38) percent are somewhat familiar, and 5 percent claim to be very familiar. The familiarity gap varies with firm size. Owners of larger small businesses are more familiar with the law than owners of smaller businesses. This gap is not surprising as owners of larger businesses tend to utilize accountants and lawyers more frequently than owners of smaller ones.

Fewer than half (44 percent) of small business owners have talked with a tax professional or advisor about how the new tax law will affect their business (Q#11). Fifty-six percent have not. The percent of owners having talked with a tax advisor increases by firm size with almost two-thirds (63 percent) of employers with more than 100 employees having done so compared to 35 percent of non-employers.

Of owners with some familiarity with the law, the main source of information for 50 percent of small business owners is a tax preparer or advisor (Q#8). Twenty-eight percent received most of their information from the general news media and 11 percent from a trade or business association. Combined, other business owners and general internet information were the main source for 11 percent of small business owners. Government was the main source of information for only 1 percent of them.

Small business owners are generally satisfied with the level of information they received about the law. Nearly three-fourths (73 percent) of small business owners are very or somewhat satisfied (Q#9). One-quarter reported being less satisfied, and just 3 percent are not at all satisfied.

One of the most beneficial provisions within the tax law for small business owners is the newly created Section 199A, which allows most small businesses, those organized as a partnership, S corporation, LLCs or sole proprietorship, to deduct up to 20 percent of qualified business income from their federal income taxes. However, only 7 percent of small business owners are very familiar with the provision, 19 percent are somewhat familiar, and 40 percent are not very familiar (Q#10). One-third of small business owners have no familiarity with the provision at all. As with familiarity of the law generally, owners of larger small business are more familiar with this provision than owners of smaller business. While half of owners with more than 100 employees are familiar with the provision, only 23 percent of non-employers are familiar. Those who are least familiar with the deduction are most likely to be eligible for it.

Owners' Reaction to TCJA

The vast majority (76 percent) of small business owners believe the current business climate is heading in a positive direction (Q#4). The U.S. economy is strong with GDP growth averaging 2.6 percent in 2017, nine years after the Great Recession.[6] The 2016 election buoyed small business enthusiasm with the promise of lower taxes and fewer regulations, two top concerns for small business owners. The *Tax Cuts and Jobs Act* was a giant step in addressing some of these pressing concerns.

Economy

The reaction to the new tax law has been overwhelmingly positive as initially reported in NFIB's monthly *Small Business Economic Trends* report. The *Index of Small Business Optimism* reached record level high readings after the law passed in conjunction with a swift decline in the percent of owners reporting taxes as their *single most important problem* in operating their business.[7] This survey shows similar enthusiasm with 87 percent of small business owners expecting that the tax law will have a positive impact

[6] https://www.bea.gov/newsreleases/national/gdp/2018/pdf/gdp1q18_adv.pdf
[7] *NFIB Small Business Economic Trends*, (ids.) William C Dunkelberg and Holly Wade, NFIB Research Center, series. www.nfib.com/sboi

on the general economy (Q#14). Just 4 percent believe it will negatively impact the general economy, and 9 percent think it will have no significant impact.

Business

Three-fourths of small business owners believe the tax law will positively impact their business, 22 percent anticipate it will have no impact, and 3 percent a negative impact (Q#12). While larger small firms are most enthusiastic about how the law will impact their business, they are also most knowledgeable about the law generally. As owners of smaller businesses talk to their tax professional, more will likely find the law positively impacting their business.

Personal

When asked about the law's impact on their personal taxes, 70 percent anticipate it will positively impact them while 23 percent expect it to have no impact (Q#13). Seven percent believe it will have a negative impact on their personal taxes. Owners' expectations about how the law will affect their personal tax filing varies little by firm size.

Investment Plans

About half (51 percent) of small business owners anticipate paying less in federal income taxes in 2018 compared to 2017, assuming their business income remains the same (Q#15). About 37 percent believe they would pay the same amount. Only 7 percent thought they would pay more and 6 percent were unsure.

Small business owners anticipating a lower tax bill next year plan to allocate the extra money across a number of business activities. But because many owners have yet to talk with their tax accountant or know how much they will save, about half say it is still too soon to know how they will spend the extra cash (Q#15a1).[8] Almost half (47 percent) plan to increase business investments with their tax savings (Q#15a5) and 44 percent plan to increase employee compensation (Q#15a6). Another 40 percent of small business owners plan to pay down debt obligations (Q#15a7), and 32 percent plan to retain the funds freed up as higher earnings available to support business growth (Q#15a4). Over one-quarter (27 percent) of small business owners plan to use the extra savings to help hire an additional employee (Q#15a3). According to NFIB's monthly survey, the percent of owners with an unfilled job opening reached 35 percent again in April 2018, the highest reading since November 2000.[9] The tax savings will help many in this category in filling open positions.

[8] Respondents who did not answer questions Q15a1 – 7 are evaluated as answering "no" for each.
[9] *NFIB Small Business Economic Trends*, (ids.) William C Dunkelberg and Holly Wade, NFIB Research Center, series. www.nfib.com/sboi. Unfilled job openings also reached 35 percent in March 2018, July and October 2017.

Tax Complexity

Tax complexity is a major concern for small business owners, with over one-quarter of them (27 percent) finding it a *critical* problem in operating their business.[10] Because of the complex nature of filing taxes, most small business owners solicit professional tax help to assist them with the process. The survey found that 93 percent of small business owners use a tax professional to prepare their federal business income tax return, resources that could otherwise be used to grow the firm if taxes were simplified (Q#17). Small business owners do not see the process changing much over the next year. About three-fourths of small business owners (73 percent) expect the time and money it took to prepare their 2017 return to be about the same in 2018 (Q#18). Sixteen percent anticipate spending more time and money next year compared to this year, likely due to navigating the new tax law. This should then ease after the first year's filing once owners learn more about how the new law affects them and their business. More owners of larger businesses are anticipating allocating more resources to next year's tax filing than smaller businesses.

About two-thirds (67 percent) of small business owners itemized their personal deductions when filing their most recent federal tax return (Q#16). Twenty-two percent of small business owners took the standard deduction. Eleven percent did not know if they itemized or took the standard deduction. Most owners who itemized their 2017 tax return plan to itemize again for their 2018 return, anticipating that their deductions will continue to be above the new thresholds of $12,700 for single filers and $24,000 for joint filers. About 56 percent plan to itemize, and 10 percent anticipate using the standard deduction (Q#16a). About one-third (34 percent) were not familiar enough with the new law to know which choice to make.

The tax law is widely popular among small business owners, but many of the benefits expire at the end of 2025 including the reductions to the individual tax rates and Section 199A, the up to 20 percent deduction on qualified business income. At this time, the January 1, 2026 expiration date is not affecting most small business owners. Only 12 percent of small business owners, disproportionately larger ones, say that this uncertainty will affect current or future business plans (Q#19). Another 56 percent say it currently does not affect any short- or long-term business plans. The remaining 32 percent of small business owners don't know. This population will likely transition into either the "no" or "yes" categories in future editions of the survey as it gets closer to 2026 if Congress fails to provide more certainty.

Evaluation of Changes to Tax Provisions

The impact of the new tax law on small business owners will vary from business to business depending on their unique set of circumstances and business characteristics. But even provisions that don't directly affect most small business owners are of great

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[10] *Small Business Problems and Priorities*, Holly Wade, NFIB Research Center, 2016. www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf

concern to many more due to future uncertainties and frequent changes in the federal and state tax codes.

Section 199A

The provision that is most viewed as "very" important to small business owners and their business is the creation of the up to 20 percent small business income tax deduction, Section 199A. While many small business owners are not familiar with it, the mere mention of it provokes a strong, positive reaction with 55 percent of owners saying that it's a very important provision and another 29 percent somewhat important provision (Q#20B) to them and their business.

Corporate Tax Rate

The next most popular provision is the corporate tax cut with 52 percent of small business owners viewing it as very important and 23 percent somewhat important (Q#20G). Even those small business owners not structured as C corporations endorse the lower rate, whether because it now offers a reasonable option for switching legal organization or they generally think it's good policy.

Individual Income Tax Rates

The changes to the individual income tax brackets and rates are a very important provision in the tax law for 45 percent of small business owners and somewhat important for another 40 percent of them (Q#20A).

Estate Tax

The new tax law increases the estate tax exemption from $5.5 million to $11 million for single filers and $11 million to $22 million for joint filers, protecting more small business owners from tax preparation related expenses. Forty-one percent view the estate tax as a very important issue (Q#20D). A relatively small percentage of business owners end up paying the estate tax but many more seek professional guidance on how to prepare for it or evaluate the likelihood of being affected by it in the future. About one-in-five (21 percent) small business owners have incurred estate tax related expenses in the last five years, and another 5 percent plan to in the future (Q#21). Of those who have incurred expenses, 42 percent say that the increased estate tax threshold will reduce or eliminate their potential estate tax liability (Q#21a). About one quarter (24 percent) say that it will have no impact, and another 34 percent don't know.

AMT

The expiration of tax provisions (Q#20H) and the AMT (Q#20C) are important to many small business owners but fewer compared to other provisions in the new tax law. Fifty-three percent of small business owners find changes to the AMT threshold an important tax provision and 57 percent find the expiration of certain tax provisions important.

SALT

The new tax law also capped the amount of state and local income and property taxes (SALT) filers can deduct from the personal federal income taxes. The new limit is an important change for about two-thirds of small business (Q#20E). The SALT provision is of particular concern for those owners located in high income or property tax states. While the personal SALT deduction is capped at $10,000, business related SALT taxes are expected to remain deductible.

Individual Mandate

Beginning in 2019, the new tax law also eliminates the individual health insurance mandate penalty that was created in the Affordable Care Act. About 29 percent of small business owners purchase their health insurance on the individual market, including on an individual health insurance exchange (Q#22). Over 70 percent of them say the elimination of the penalty will not affect their current coverage status or insurance plan (Q#22a). About 12 percent will consider purchasing a different insurance plan, presumably a cheaper, currently non-compliant plan. Only 3 percent plan to drop their coverage altogether.

Expensing

The new tax law also increased the business expensing limits from $510,000 to $1,000,000 for eligible capital expenditures and expanded the list of eligible expenditures. Small business owners in capital intensive industries will benefit from this change but, overall, fewer than 5 percent spend more than $500,000 in any given year.[11] Seventeen percent of small business owners say that the new expensing limit will affect their investment plans over the next 1 – 3 years (Q#23). The majority of small business owners (60 percent) do not anticipate the change will affect future expenditure plans in the near term. Another 23 percent are not sure.

Small Business Income

For most small business owners, business income accounts for a significant portion of their total household income. Business profits are the sole income source for 39 percent of small business owners (Q#27). Owners have a substantial amount of their net worth tied up in their business, amplifying the importance of tax law changes on their economic well-being. These small business owners are totally reliant on the success of their business as a source of income. Owners of larger small businesses are more likely to have business profits as their sole income source. For one in five owners, business earnings contribute to less than half of the overall household income, disproportionally more frequent for owners of smaller businesses. About one-quarter (26 percent) of

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[11] *NFIB Small Business Economic Trends*, (ids.) William C Dunkelberg and Holly Wade, NFIB Research Center, series. www.nfib.com/sboi

small businesses derive most (75-99 percent) of their household income from business profits.

Final Comments

The data for this survey capture small business owners' initial reaction to the new tax law. Taxes and tax related activities play a significant role in the general operations of small businesses. Small business owners are now assessing how these changes will affect them personally and their business. The new tax law is a significant step forward in easing one of the main concerns of small business owners: the impact of federal taxes on business income. However, the complexity of the tax code remains. Owners will continue to seek professional assistance to understand and comply with the new code. But the reduction in taxes will free up resources to support the growth of their business and ease issues related to intergenerational changes in management.

Methodology

This survey was conducted with a random sample of 20,000 NFIB members between February and April 2018. The survey was conducted by mail, with an initial mailing and a follow-up mailing 3 weeks later. NFIB collected 2,544 usable responses, a 13 percent response rate. Ninety-five percent of respondents were the owner of the business, 4 percent a manager.

SMALL BUSINESS TAX SURVEY 2018

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Which best describes your position in this business? Are you a(n):?					
1. Owner-manager	89.4%	92.3%	86.2%	84.7%	90.9%
2. Owner, but not a manager	4.2	3.8	4.2	1.7	3.9
3. Manager, but not an owner	4.2	2.7	8.4	11.9	4.0
4. Other	2.1	1.1	1.2	1.7	1.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	236	1833	405	59	2533
2. What is the legal form of your business?					
1. Sole proprietorship	44.4%	20.3%	0.7%	--%	18.9%
2. Partnership	3.9	3.4	1.2	1.7	3.1
3. LLC	25.4	20.1	13.6	22.0	19.6
4. S-Corporation	19.4	40.8	58.9	50.8	42.0
5. C-Corporation	6.9	15.4	25.5	25.4	16.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	232	1827	404	59	2522
2a. If structured as a C-corporation, what is the main reason it is structured that way:?					
1. Tax purposes	--%	32.6%	30.2%	--%	33.1%
2. Liability purposes	--	33.6	25.9	--	31.0
3. Legacy (always been that way)	--	29.7	38.8	--	31.0
4. Other ______	--	4.1	5.2	--	4.8
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	38	309	116	18	583

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
			Employee Size of Firm		
3. What is the primary industry of your business?					
1. Construction	15.2%	14.1%	24.0%	11.9%	15.8%
2. Manufacturing	4.2	8.2	19.8	30.5	10.2
3. Agriculture	31.2	16.2	6.2	10.2	15.9
4. Retail, Wholesale	13.9	20.7	19.3	15.3	19.7
5. Finance, Insurance, Real Estate	3.0	7.5	1.7	--	6.0
6. Transportation/Warehousing	3.0	2.0	4.9	3.4	2.6
7. Services (personal/prof.)	16.0	18.0	11.4	10.2	16.5
8. Other (specify) _______	13.5	13.2	12.8	18.6	13.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	237	1831	405	59	2532
4. Do you think the current business climate is generally headed a positive or negative direction?					
1. Very positive	9.8%	13.2%	15.2%	20.3%	13.4%
2. Positive	57.0	62.2	69.9	69.5	63.1
3. Negative	11.9	10.8	6.7	3.4	10.1
4. Very negative	2.1	1.2	0.5	1.7	1.2
5. Don't know	19.1	12.7	7.7	5.1	12.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	235	1808	402	59	2504
5. Are you primarily responsible for making financial and tax related decisions for this business?					
1. Yes	95.7%	95.4%	94.6%	88.1%	95.1%
2. No	4.3	4.6	5.4	11.9	4.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	234	1832	405	59	2530
6. Do you plan to change the legal form of your business in the next 1 – 3 years?					
1. Yes	3.0%	4.9%	1.5%	1.7%	4.1%
2. No	86.8	82.2	87.1	74.6	83.3
3. Not sure	10.2	12.9	11.4	23.7	12.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	235	1834	404	59	2532

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

6a. If you are planning to change the legal form of your business, what are you changing it to?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. C-Corporation	---%	14.4%	--%	--%	18.6%
2. S-Corporation	--	27.9	--	--	29.3
3. Partnership	--	4.8	--	--	4.5
4. Sole proprietorship	--	7.9	--	--	7.2
5. LLC	--	45.0	--	--	40.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	21	229	32	8	290

6b. What is the main reason you planning to change it?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Tax purposes	--%	44.8%	--%	--%	48.8%
2. Liability purposes	--	24.6	--	--	22.2
3. An ownership change	--	21.3	--	--	19.5
4. Other	--	9.3	--	--	9.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	23	268	38	9	338

7. The recently passed federal tax law named the Tax Cuts and Jobs Act is currently being implemented. How familiar are you with this new law? Are you:

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very familiar	3.4%	4.2%	7.7%	18.6%	5.0%
2. Somewhat familiar	33.3	34.8	54.1	61.0	38.3
3. Not too familiar	29.5	35.0	26.9	13.6	32.7
4. Not at all familiar	33.8	26.0	11.4	6.8	23.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	237	1826	405	59	2527

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

8. From which source have you obtained the most useful information about how the new tax law will affect your business?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Tax preparer or advisor	53.8%	47.1%	56.0%	70.9%	50.0%
2. Other business owners	3.8	3.0	1.7	1.8	2.8
3. Government	3.1	0.7	0.6	--	0.9
4. Trade associations or business groups	4.4	11.6	9.1	12.7	10.6
5. General news media (TV, radio, newspaper)	30.0	29.8	23.8	14.5	28.3
6. Internet	5.0	7.7	8.9	--	7.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	160	1347	361	55	1923

9. Overall, how satisfied are you with the clarity and usefulness of the information received related to you and your business? Are you:?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very satisfied	10.8%	8.2%	12.5%	28.3%	9.6%
2. Somewhat satisfied	68.2	61.7	64.2	60.4	62.6
3. Not too satisfied	18.5	27.3	20.6	11.3	24.9
4. Not at all satisfied	2.5	3.1	2.8	--	2.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	157	1343	360	53	1913

10. The new tax law allows owners of pass-through businesses (LLC's, partnerships, sole proprietorship or S-corporations), with taxable income below $157,500 as a single filer or $315,000 if married and file jointly, to deduct 20 percent of qualified business income from taxable income.

How familiar are you with this new tax provision?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very familiar	2.5%	6.4%	11.0%	17.9%	7.3%
2. Familiar	19.9	18.0	22.4	32.1	19.4
3. Somewhat familiar	41.0	40.6	37.8	33.9	39.9
4. Not at all familiar	36.6	34.9	28.7	16.1	33.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	161	1369	362	56	1948

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

11. Have you talked with a tax professional or advisor to discuss how the new tax law will affect your business?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	35.4%	41.0%	54.3%	62.5%	43.7%
2. No	64.6	59.0	45.7	37.5	56.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	158	1358	363	56	1935

12. Do you think the new tax law will have a positive, negative, or no impact on your business?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very positive	11.2%	10.7%	15.7%	27.3%	12.1%
2. Positive	62.5	63.0	62.5	54.5	62.6
3. No impact	23.0	22.8	20.7	16.4	22.3
4. Negative	2.0	3.4	1.1	1.8	2.8
5. Very negative	1.3	0.2	--	--	0.2
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	152	1323	357	55	1887

13. Do you think the new tax law will have a positive, negative, or no impact on your personal taxes?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very positive	7.9%	7.3%	10.9%	8.9%	8.1%
2. Positive	61.6	62.6	61.8	58.9	62.2
3. No impact	24.5	23.2	20.1	23.2	22.7
4. Negative	6.0	6.2	6.4	7.1	6.2
5. Very negative	--	0.8	0.8	1.8	0.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	151	1325	359	56	1891

14. Do you think the new tax law will have a positive, negative, or no impact on the general economy?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very positive	17.2%	18.9%	18.8%	20.0%	18.8%
2. Positive	70.2	66.1	72.4	74.5	67.9
3. No impact	9.3	10.5	5.8	5.5	9.4
4. Negative	2.0	3.8	2.8	--	3.4
5. Very negative	1.3	0.7	0.3	--	0.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	151	1361	362	55	1893

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

15. Assuming you have the same level of business income in 2018 as in 2017, do you expect to pay more, less, or about the same in federal income taxes in 2018 than in 2017?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. A lot more	0.6%	0.6%	0.6%	1.8%	0.6%
2. More	5.0	6.0	5.2	1.8	5.6
3. About the same	41.5	37.9	33.1	30.4	37.1
4. Less	45.3	47.0	53.6	58.9	48.5
5. A lot less	--	2.1	3.3	1.8	2.1
6. Not sure	7.5	6.5	4.1	5.4	6.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	159	1361	362	56	1938

15a. If less or a lot less, how do you plan to spend the cash previously used for taxes?
("No" also includes those who did not answer the question.)

1. Too soon to tell	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	55.6%	52.1%	42.2%	41.2%	49.9%
2. No	44.4	47.9	57.8	58.8	50.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980

2. Lower prices	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	1.4%	2.5%	3.4%	5.9%	2.8%
2. No	98.6	97.5	96.6	94.1	97.2
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980

3. Hire additional employees	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	22.2%	25.4%	29.1%	44.1%	26.6%
2. No	77.8	74.6	70.9	55.9	73.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980

4. Retain as earnings	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	34.7%	31.9%	32.5%	38.2%	32.4%
2. No	65.3	68.1	67.5	61.8	67.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
			Employee Size of Firm		
5. Increase business investment/expansion					
1. Yes	40.3%	46.3%	49.0%	67.6%	47.1%
2. No	59.7	53.7	51.0	32.4	52.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980
6. Increase employee compensation					
1. Yes	25.0%	44.8%	46.6%	61.8%	44.3%
2. No	75.0	55.2	53.4	38.2	55.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980
7. Pay down debt obligations					
1. Yes	38.9%	40.6%	36.9%	52.9%	40.1%
2. No	61.1	59.4	63.1	47.1	59.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980
8. Other					
1. Yes	4.2%	1.5%	0.5%	--%	1.4%
2. No	95.8	98.5	99.5	100.0	98.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	72	668	206	34	980

16. Last year, did you itemize your personal deductions when filing your federal tax return or take the standard deduction?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Itemized	50.4%	63.0%	77.3%	84.2%	66.6%
2. Standard deduction	35.5	24.7	15.3	14.0	22.2
3. Not sure	14.1	12.3	7.5	1.8	11.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	234	1441	400	57	2496

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

16a. The new tax law doubled the personal standard deduction. If you itemized last year, do you plan to itemize deductions again next year?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	57.5%	54.7%	61.6%	62.2%	56.4%
2. No	8.3	10.5	8.0	6.7	9.8
3. Don't know	34.2	34.8	30.4	31.1	33.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	120	1124	276	45	1565

17. Did you use a professional tax preparer, a tax software package, both, or neither to prepare your last federal business income tax return?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Used professional tax preparer	85.2%	91.6%	92.8%	94.8%	91.3%
2. Used tax software package	8.9	4.4	5.0	3.4	4.9
3. Used both a tax professional and tax software	3.8	2.4	1.5	--	2.3
4. Used neither a tax professional nor tax software	1.7	1.0	0.2	--	0.9
5. Other	0.4	0.7	0.5	1.7	0.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	237	1831	403	58	2529

18. In terms of time and money, do you expect tax preparation for you and your business to cost more, less, or about the same in 2018 as in 2017?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. More	11.4%	16.9%	15.3%	24.1%	16.3%
2. Less	3.4	3.8	4.4	1.7	3.8
3. About the same	73.7	73.0	73.3	65.5	72.9
4. Not sure	11.4	6.4	6.9	8.6	7.0
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	236	1831	405	58	2530

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
			Employee Size of Firm		

19. Most of the new tax law's personal and pass-through business (LLCs, S-Corp, Partnerships, Sole Proprietors) tax provisions expire in 2025.

Does this uncertainty, not knowing how tax policy will change after 2025, affect your current or future business plans?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	10.0%	11.8%	11.7%	29.8%	12.1%
2. No	53.0	55.1	61.6	50.9	55.8
3. Don't know	37.0	33.1	26.7	19.3	32.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	230	1800	393	57	2480

20. How important are the following changes in the tax law to you and your business?

A. Changes to the personal income tax brackets and rates

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very important	39.0%	44.8%	49.1%	45.8%	45.0%
2. Somewhat important	37.3	40.7	39.2	50.8	40.4
3. Not very important	7.5	5.8	5.7	1.7	5.8
4. Not at all important	0.4	0.9	1.0	1.7	0.9
5. Don't know	15.8	7.7	5.0	--	7.8
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	228	1809	401	59	2497

B. Creation of the 20% small business income tax deduction

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very important	46.5%	56.1%	56.4%	50.8%	55.2%
2. Somewhat important	33.5	28.8	28.2	23.7	29.0
3. Not very important	5.2	4.2	6.0	15.3	4.8
4. Not at all important	0.9	1.2	2.7	6.8	1.5
5. Don't know	13.9	9.8	6.7	3.4	9.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	230	1812	401	59	2502

C. Changes to the personal or corporate Alternative Minimum Tax (AMT) threshold

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very important	19.3%	21.8%	31.0%	29.3%	23.3%
2. Somewhat important	28.7	28.9	32.0	34.5	29.5
3. Not very important	13.0	14.0	13.0	20.7	13.9
4. Not at all important	7.2	4.2	3.8	1.7	4.4
5. Don't know	31.8	31.0	20.3	13.8	28.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	223	1790	400	58	2471

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
D. Changes to the estate tax					
1. Very important	33.6%	39.8%	47.3%	62.7%	40.9%
2. Somewhat important	26.7	24.4	27.6	18.6	25.0
3. Not very important	15.5	14.1	13.4	11.9	14.1
4. Not at all important	5.2	6.0	3.5	3.4	5.5
5. Don't know	19.0	15.7	8.2	3.4	14.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	232	1811	402	59	2504
E. Limiting the State and Local Tax deduction					
1. Very important	24.5%	32.9%	31.0%	35.6%	31.9%
2. Somewhat important	36.2	34.1	40.3	37.3	35.4
3. Not very important	12.7	11.2	14.2	20.3	12.1
4. Not at all important	3.9	4.5	3.5	5.1	4.3
5. Don't know	22.7	17.2	11.0	1.7	16.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	229	1806	400	59	2494
F. Doubling the standard deduction					
1. Very important	41.6%	44.5%	36.2%	22.0%	42.3%
2. Somewhat important	34.6	33.3	36.9	39.0	34.1
3. Not very important	7.8	8.1	13.2	27.1	9.3
4. Not at all important	1.3	2.4	4.2	8.5	2.7
5. Don't know	14.7	1.8	9.5	3.4	11.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	231	1804	401	59	2495
G. Lowering the corporate tax rate					
1. Very important	35.5%	50.9%	62.6%	71.2%	51.8%
2. Somewhat important	23.2	24.1	20.7	13.6	23.2
3. Not very important	11.0	8.2	5.7	5.1	8.0
4. Not at all important	11.8	6.1	4.7	10.2	6.5
5. Don't know	18.4	10.8	6.2	--	10.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	228	1811	401	59	2499

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

H. Expiration of the law's tax provisions (excluding corporate rate and corporate AMT which are permanent)

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Very important	20.4%	22.0%	26.8%	35.6%	22.9%
2. Somewhat important	28.8	33.3	41.3	37.3	34.3
3. Not very important	15.0	12.6	10.0	5.1	12.2
4. Not at all important	2.2	1.7	0.3	3.4	1.5
5. Don't know	33.6	30.5	21.8	18.6	29.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	226	1796	400	59	2481

21. Have you incurred any expenses in the last 5 years, such as consulting a tax advisor or purchasing more life insurance, etc., than you otherwise would to reduce or eliminate any potential tax liability from the estate tax?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	10.0%	20.4%	26.9%	53.4%	21.2%
2. No	81.2	71.7	66.8	39.7	71.0
3. No, but expect to in the future	4.4	5.0	4.3	6.9	4.9
4. Do not plan to pass on the business	4.4	3.0	2.0	--	2.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	229	1796	394	58	2477

21a. Do you expect the increased estate tax threshold to affect your strategy for reducing or eliminating any potential estate tax liability?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	20.6%	40.7%	49.5%	62.1%	42.1%
2. No	29.4	23.6	24.8	24.1	24.2
3. Not sure	50.0	35.7	25.7	13.8	33.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	34	423	105	29	591

22. Last year, did you purchase a health insurance plan on the individual market (including on an exchange)?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	25.6%	31.6%	22.7%	14.8%	29.3%
2. No	74.4	68.4	77.3	85.2	70.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	219	1738	392	54	2403

	Employee Size of Firm				
	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms

22a. The new tax law repeals the penalty for not having health insurance. Will this change affect your decision to purchase health insurance or the type of plan purchased?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes, I will likely drop my health insurance coverage	4.7%	2.7%	4.7%	--%	3.1%
2. Yes, I will likely purchase a different insurance plan	9.4	12.7	7.8	--	11.8
3. No, I will likely keep my insurance plan	68.2	70.5	75.2	--	71.0
4. Not sure	17.6	14.1	12.4	--	14.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	85	733	129	12	959

23. The new tax law increases business expensing limits from $510,000 to $1,000,000 for eligible capital expenditures. Will this change affect your investment plans over the next 1 – 3 years?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Yes	11.6%	13.5%	32.3%	51.7%	17.3%
2. No	69.2	62.8	45.6	41.4	60.1
3. Not sure	19.2	23.6	22.1	6.9	22.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	224	1787	399	58	2468

24. What is your personal federal income tax filing status?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. Single	18.5%	15.9%	9.1%	12.5%	15.0%
2. Married, filing jointly	76.4	79.6	86.1	85.7	80.5
3. Married, filing separately	1.7	2.1	2.8	--	2.1
4. Head of household	3.4	2.4	2.0	1.8	2.4
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	233	1821	397	56	2507

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
			Employee Size of Firm		

25. Approximately, what were your gross sales in your last fiscal year?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. < $100,000	30.1%	6.6%	0.8%	1.8%	7.7%
2. $100,000 - $249,999	21.7	13.8	4.3	--	12.7
3. $250,000 - $499,999	14.2	19.5	4.5	--	16.1
4. $500,000 - $999,999	9.3	22.6	4.0	--	17.9
5. $1m - $4.9m	10.2	28.8	37.4	5.4	28.0
6. $5m - $9.9m	3.1	2.1	25.1	10.7	6.1
7. $10m plus	1.3	0.9	16.8	76.8	5.2
8. Prefer not to answer	10.2	5.7	7.0	5.4	6.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	226	1791	398	56	2471

26. If owner, how many businesses (in total) do you have at least a 25% ownership share in?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. One	80.7%	68.3%	50.1%	26.5%	65.8%
2. Two	13.3	21.8	28.3	24.5	22.1
3. Three	4.1	6.8	14.3	20.4	8.0
4. More than three	1.8	3.1	7.3	28.6	4.1
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	218	1774	371	49	2412

27. What percent of your total household income comes from your business(es)?

	No emp.	1-19 emp.	20-99 emp.	100+ emp.	All Firms
1. 1 – 25%	23.5%	8.7%	4.7%	3.7%	9.3%
2. 26 – 50%	12.4	11.6	5.7	3.7	10.5
3. 51 – 75%	15.0	16.0	11.9	9.3	15.1
4. 76 – 99%	20.4	25.6	30.9	31.5	26.1
5. 100%	28.8	38.1	46.8	51.9	38.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%
N	226	1791	385	54	2456

Written Testimony to the Joint Economic Committee of the U.S. Congress
by
John Hinderaker, President, Center of the American Experiment
September 6, 2018

INTRODUCTION

Chairman Paulsen, Ranking Member Heinrich, members of the Joint Economic Committee, thank you for the invitation to provide testimony for this important hearing. My name is John Hinderaker and I am President of Center of the American Experiment, a non-profit organization dedicated to promoting freedom and limited government. The subject of my testimony is the impact of the Tax Cuts and Jobs Act on the economy of Minnesota, where my organization is headquartered.

THE PASSAGE OF THE TAX CUTS AND JOBS ACT

It is early, of course, to judge the full impact of the Tax Cuts and Jobs Act on Minnesota's economy. The Act was passed in December 2017, just over eight months ago, and it went into effect a month later. Further, it was not clear until a very late stage that the Act would pass. As late as November 6, 2017, the state of Minnesota's own economic consultants released a forecast that removed from its baseline outlook the federal fiscal stimulus of the Tax Cuts and Jobs Act – the individual income and corporate tax rate cuts as well as increased infrastructure spending – because even at that stage it was deemed unlikely that the bill would pass.

So, compounding the short time that the Act's measures have actually been in place, is the brief period of time prior to that in which businesses and individuals could plan for the new fiscal environment. Given those facts, is is remarkable how much impact can already be demonstrated.

SOURCES

We can interrogate several sources to gain insight into the effects of the Act on our state's economy. First are news reports on actions taken by individual companies; second is official data; third are indexes of business sentiment; and fourth are forecasts.

News Stories About Individual Companies

The first source of evidence is news reports of companies that have raised wages, awarded bonuses, increased hiring, and so on, in response to the Act. We have documented at least 34 such instances in Minnesota, all specifically attributed to passage of the Tax Cuts and Jobs Act. They are listed in Appendix A. No doubt there are many more that have not been publicly reported.

For example, bonuses ranging from $200 to $2,000 were given to Minnesota employees from both large and small companies. Albert Lea Public Warehouse gave each of its 12 employees an extra $2,000. Larger companies, like U.S. Bancorp, gave $1,000 bonuses to each of its 60,000 employees. Employees also saw an increase in hourly wages. Hormel raised their hourly pay to $13/hr. Koch Companies increased driver pay from 41 cents to 45 cents per mile and raised the maximum driver sign-on bonuses from $5,000 to $7,000. Other employers expanded their retirement plan contributions, pension programs, stock grants, maternity and paternal leave, adoption assistance, and vacation benefits. Companies are also investing in themselves. CIT Relay & Switch in Rogers increased its staff by 10% in January 2018 and have pledged to hire even more. 3M invested $1.9 billion in 2017 in research and development and have expanded that investment in 2018.

Utility companies passed their tax savings on to customers. Minnesota Power in Duluth is giving customers a 1.5259% credit on their monthly bills, a savings totaling about $10 million a year. Otter Tail Power is also reducing its rates. Residential customers will see savings of about $3.10 a month where commercial customers will have a $18.25 rate cut.

Minnesota companies have also donated more than $200 million to charity as a result of the Act. U.S. Bancorp made $150 million charitable contribution. Best Buy gave $20 million to their foundation. Ecolab made a $25 million contribution to their foundation.

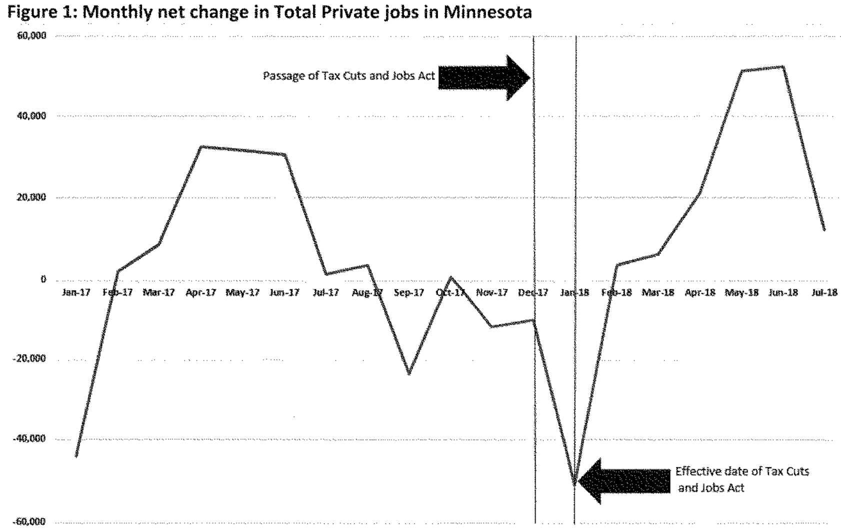
Official data

Some official data sets are not updated often enough to reflect, at this point, the impact of the Tax Cuts and Jobs Act. For example, Bureau of Economic Analysis data on Gross Domestic Product and Personal Income at the state level have only been released through the first quarter of 2018. But we do have some significant data. In particular, the Bureau of Labor Statistics compiles monthly data on employment and wages.

Employment

Figure 1 is based on data from the BLS' Current Employment Statistics and shows the net gain or loss of jobs in each month since January 2017. It shows that hiring goes through cycles in Minnesota. Jobs are added during the spring and summer months, and lost in fall and winter. Figure 2 shows that the peak net-gain of jobs in 2018, 52,000 in June, was nearly 20,000 higher than the peak month in 2017, April.

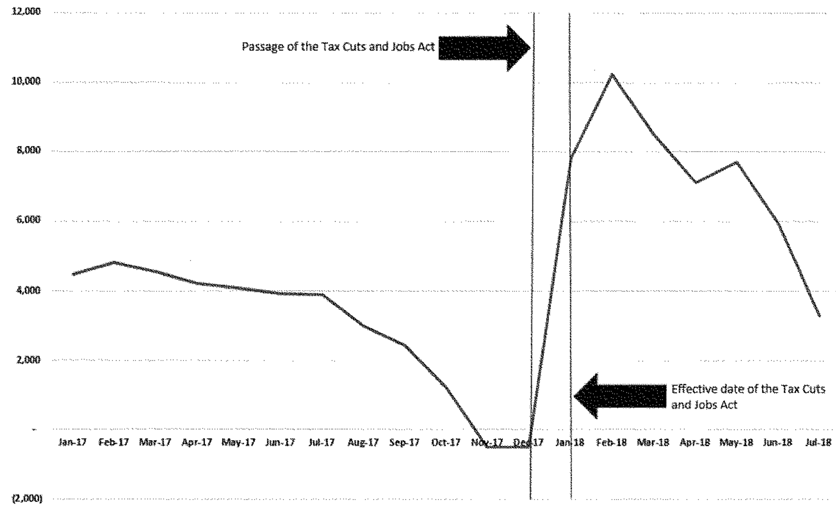
Figure 1: Monthly net change in Total Private jobs in Minnesota



Source: Bureau of Labor Statistics

The BLS also produces its Local Area Unemployment Statistics on a monthly basis. Figure 2 shows the net change in seasonally adjusted employment in Minnesota since January 2017. We see that an average rate of employment growth of around 4,000 jobs per month trended down from July and turned negative at the end of the year. However, it then rebounded strongly from December, with 10,000 new jobs added on net in February 2018, a rate not seen in this data since at least January, 2008.

Figure 2: Monthly net change in seasonally adjusted employment in Minnesota

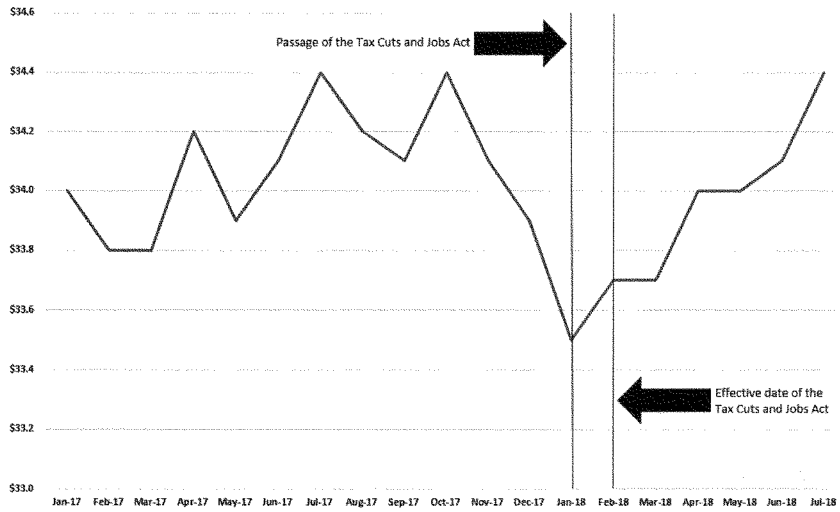


Source: Bureau of Labor Statistics

Wages

The Current Employment Statistics produced by the BLS also provide data on weekly earnings. Figure 3 shows this data from January 2017 onward. We see a trend of wage growth in 2017 which abated from October to January. Since then, in nominal terms, average weekly earnings in Minnesota have risen by 2.7 percent, compared to a 1.2 percent increase in the same period of 2017.

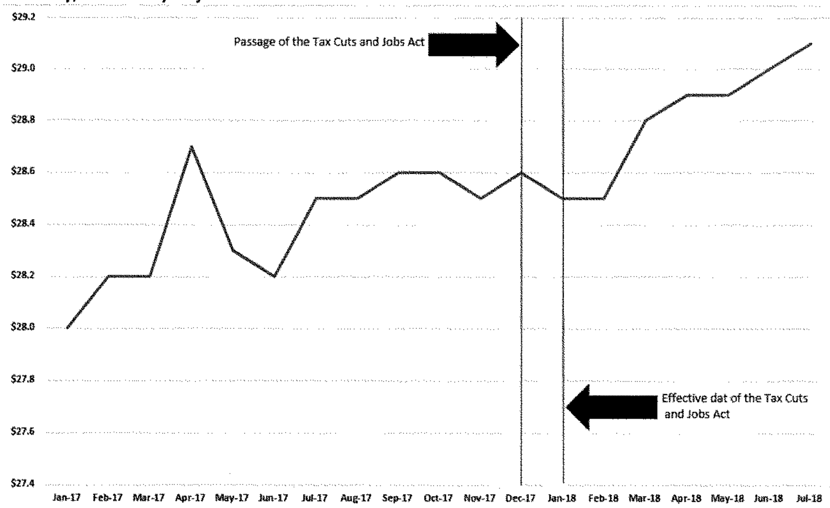
Figure 3: Average weekly earnings, Minnesota



Source Bureau of Labor Statistics

Figure 4 shows data for average hourly earnings seasonally adjusted by the Federal Reserve Bank of St. Louis. Wages more or less stagnated between July 2017 and February 2018. Since then, however, wage growth has picked up and hourly earnings in Minnesota have risen by 2.1 percent compared to 1.1 percent over the previous twelve months.

Figure 4: Average Hourly Earnings of All Employees: Total Private in Minnesota, Dollars per Hour, Monthly, Seasonally Adjusted



Source: Federal Reserve Bank of St. Louis

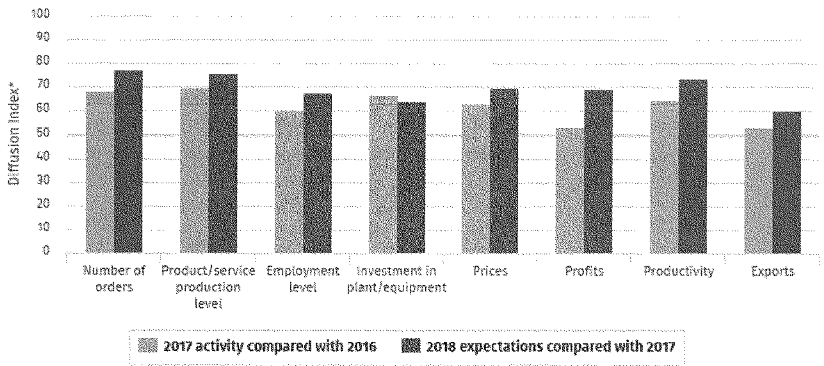
Indexes

Our third source of information is surveys of business sentiment.

In January 2018, the Federal Reserve Bank of Minneapolis reported on sentiment among manufacturers in the Ninth District, which covers Minnesota, Montana, North and South Dakota, and portions of Wisconsin and Michigan. They found that 2017 had been a better year than 2016, when manufacturing activity had been more or less flat. Looking to 2018, the Minneapolis Fed reported that:

> *The outlook for 2018 is upbeat, with more respondents predicting growth than were expecting contraction this year. Orders, total production and exports were expected to increase. Companies forecast greater productivity and profits, as well as higher prices for their goods. Capital investment was also expected to increase.*
> *****
> *Firms' optimism about their own performance was mirrored by a positive view of the economic outlooks for their respective states. The majority of respondents expected their state economies to grow and foresaw increased employment, business investment, consumer spending and corporate profits over the coming year.*

Figure 5: Manufacturing activity increased in 2017; more growth expected in 2018

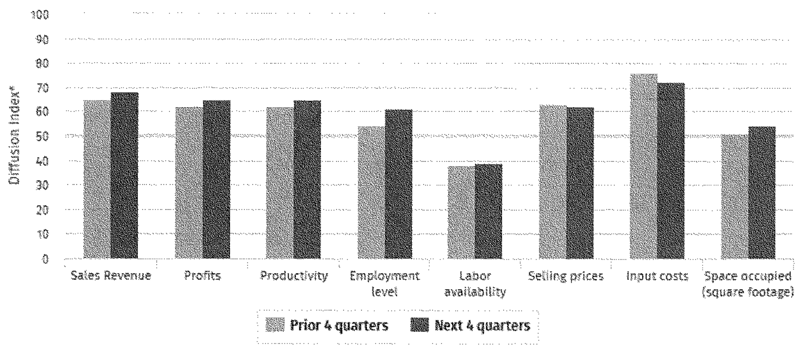


Source: Federal Reserve Bank of Minneapolis

In July, the Minneapolis Fed reported that a survey of Ninth District consultants, engineers, staffing agents, advertisers, and other professional services firms indicated that these business services firms grew over the 12 months from mid-2017. The Minneapolis Fed also reported that:

> *Looking ahead, services companies are optimistic about the coming year. More firms anticipate increased sales revenue and profits over the next four quarters than expect declines. Productivity and employment are also expected to increase…*
>
> *Most anticipate moderate wage increases. Over the next four quarters, firms expect wages per worker to increase by an average of 2.5 percent and benefits by 2.1 percent. Asked about their outlooks for the broader economy, the number of professional services firms expecting employment in their states to increase over the next year was six times the number predicting a drop. Corporate profits and consumer spending were also expected to increase across district states.*

Figure 6: Professional services firms expect more growth



Source: Federal Reserve Bank of Minneapolis

Forecasts
Our fourth and final source of information is state-specific economic forecasts.

The first of these comes from the Tax Foundation. The Tax Foundation estimates that the Tax Cuts and Jobs Act will add 6,789 full time equivalent jobs to Minnesota's economy and yield a gain in after-tax income of $722.40 for each of the state's middle-income families.

We also have the forecasts of the state government's own economic consultants, IHS Markit. In February 2017, IHS Markit produced an economic forecast which included the stimulus from proposed cuts to individual and corporate tax rates. But, in their November 2017 forecast, they removed these effects. At the time, Minnesota Management and Budget wrote

> *The outlook for U.S. economic growth has weakened since Minnesota's Budget and Economic Forecast was last prepared in February 2017. The U.S. economic data coming in this year has been mixed, with slowdowns in residential and business construction, but improvements in net exports and business equipment investment. Minnesota's macroeconomic consultant, IHS Markit (IHS), has removed from their baseline outlook federal fiscal stimulus—in the form of individual income and corporate tax rate cuts and increased infrastructure spending— that in their February outlook was expected to support economic growth starting in 2018.*

In February 2018, an updated forecast was released with the effects of the Tax Cuts and Jobs Act once again factored in. This new Budget and Economic Forecast document discussed the higher forecast state government revenues, explaining that "This forecast reflects increased U.S economic growth arising in part from short term stimulus from federal tax law changes." It went on, somewhat grudgingly:

> *The short-term outlook for U.S. economic growth has improved since Minnesota's Budget and Economic Forecast was last prepared in November 2017. The economic data coming in since November has been solid, with strong consumer spending and business equipment investment, as well as rising employment and disposable income. In addition,*

Minnesota's macroeconomic consultant, IHS Markit (IHS), has incorporated into their February baseline outlook the impact of federal fiscal stimulus from the Tax Cuts and Jobs Act (TCJA). Relative to November, this change has modestly improved the U.S. economic outlook.

CONCLUSION

More time will be required for the positive effects of the Tax Cuts and Jobs Act on Minnesota's economy to be fully measured. Already, however, we can see the impact of the Act on employment and wages in the state. The official data reinforce what was already obvious from many news reports: Minnesota companies are hiring, raising wages and otherwise contributing to Minnesota's economy as a result of the Act.

Appendix A

Below are 34 examples of companies with operations in Minnesota that gave bonuses or raises, announced increased hiring, donated to charity, cut utility rates, etc., in response to the Tax Cuts and Jobs Act. No doubt there are many more such instances that have not been publicly reported.

Priority Courier Experts (St. Paul, Minnesota) – tax reform bonuses were given on Jan. 2, 2018 to employees; further, employees will receive another $500 bonus in 2018 on the anniversary of their hire date:

> *Priority Courier Experts paid a "TRUMP BUMP" to each of its 80 employees on their January 2nd, 2018 paycheck. We also expanded the "TRUMP BUMP" to pay each employee a $500 bonus on their hire anniversary date in 2018, and our hope for the future is to make the "TRUMP BUMP" Bonus permanent. – Steve Cossack, Founder/CEO,* ***Priority Courier Experts***

Industrial Weldors & Machinists (Duluth, Minnesota) - Investing in employee pensions, hiring new employees:

> *"This is an American success story of generations," Pence said of IWM, a third-generation family business that gets 70 percent of its work by rebuilding massive rock crushers used to extract taconite iron ore on the Iron Range.*
>
> *Trump tax cuts helped the business and its employees, Pence said — including thousands of dollars in investments by the company into IWM employee pensions earlier this year.*
>
> *"That's what it's all about," Pence said.*
>
> *It was an easy fact to check after the vice president's remarks. All four sibling owners of the company were on hand — Dawn Bergh and her brothers Rick, Rob and Randy Abernethy. Bergh confirmed the pension investments for the company's 32 employees.*
>
> *"The boilermakers' pension is in the toilet," Bergh said. "They're worried about it. We wanted to give them something that would keep them around. It's really hard to get employees. We're hiring right now for both a welder and a machinist." -* ***August 8, 2018, Twin Cities Pioneer Press article excerpt***

Minnesota Power (Duluth, Minnesota) – the utility will pass tax cut savings to customers:

> *"When final rates go into effect late this year, customers will start receiving a 1.5259% credit on their monthly bill through a new line item, called the tax cut rider, totaling about $10 million a year refund until our next rate case," Rutledge said.*
>
> *For a $100 power bill, that's about $1.53 returned -* ***Aug 10, 2018, Duluth News Tribune article excerpt***

Circuit Interruption Technology Inc. -- CIT Relay & Switch (Rogers, Minnesota) – One week of extra pay added to final 2017 paycheck; hiring of new employees, growing the staff by 10 percent:

> *Circuit Interruption Technology Inc. dba CIT Relay & Switch manufactures and distributes electromechanical relays and switches to the electronics, security, HVAC, appliance and automotive industries.* ***Employees were notified just before Christmas of one extra week pay***

added to their final year end check as a result of the new tax reform measure. *Due to the positive atmosphere created by the passage of the tax bill Company profit sharing combined with normal 401K contributions amounted to an additional 5% per employee for 2017. CIT has added 10% to our staff thus far in January 2018 and more additions are expected. – Rick Hampton, CIT Relay & Switch*

Albert Lea Public Warehouse (Albert Lea, Minnesota) – $2,000 bonuses for all 12 employees:

Albert Lea business leaders said the recently passed tax bill is helping them invest in their organizations.

The tax bill passed in December cut the top federal tax rate to 21 percent from 35 percent, likely putting billions of dollars in the pockets of major Minnesota companies.

Albert Lea Public Warehouse Owner Al Larson gave each of his 12 employees a $2,000 bonus, which he said would not have been possible without reduced rates. *He said he decided to pay the bonuses in January to help the workers pay off costs incurred during the Christmas season.*

"I just distributed it back to them," he said.

In addition to bonuses, Larson is installing two roofs and investing in new dock levelers.

Larson said he prefers investing company revenue locally instead of contributing more of a percentage to the federal government. – ***Jan. 30 Albert Lea Tribune article***

Otter Tail Power Co. (Fergus Falls, Minnesota) – the utility will pass along tax reform savings to customers:

Otter Tail sought to reduce its interim electric rate increase from 10.4 percent to 6.8 percent. Typical residential customers would see a reduction of about $3.10 a month, a company spokeswoman said, and business customers would see an $18.25 drop.

"Federal corporate incomes taxes are a cost of service to our customers," Otter Tail said in its request. "The reduction of the federal corporate income tax rate from 35 percent to 21 percent reduces Otter Tail's cost of providing service." – ***February 27, 2018 Bismarck Tribune article excerpt***

Koch Companies Inc. (Minneapolis, Minnesota) – increased driver wages; increased sign on bonuses:

Raised driver pay to 41 cents to 45 cents per mile and the maximum sign-on bonus to $7,000 from $5,000 prior to late December.

"Rate increases and benefits from the recent tax law reform have allowed us to re-evaluate our current driver pay to make sure we are putting money back in the pockets of our greatest asset — the driver," CEO Randy Koch said – ***Feb. 12 2018, Transport Topics article excerpt***

U.S. Bancorp (Minneapolis, Minnesota) – $1,000 bonuses for 60,000 employees; base wage hike to $15 per hour; $150 million charitable contribution:

"We believe that tax reform is positive for the U.S. economy because it provides an immediate opportunity to benefit our employees, our communities and our customers." – Andy Cecere, President and CEO

Bio-Techne (Minneapolis, Minnesota) -- $500 bonuses for all 1,650+ employees:

Many of you, particularly in the U.S., have probably been keeping up with the news the past few months on U.S. tax reform. With the passage of the bill in Congress yesterday and the President's signature, the new tax law is now official. How does this affect our company? A lot. Our current corporate income tax levels average between 29% and 31%. With this new tax law, over the next year our tax rates will drop to levels potentially as low as 21%. We don't know the total answer yet because the law is complicated, and includes tax calculations from other countries where we do business as well. What I can tell you is that we are likely to pay substantially less taxes in the U.S. and overall.

There has been extensive media coverage here in the U.S. on what companies will do with these gains. The U.S. Government's primary goal for the new law is that companies will use the additional monies to invest in growth, and not simply to benefit shareholders through a dividend increase or share buyback. I am happy to tell you that we will use the savings to invest in our company and in you. We will use the funds to continue our investment in the company through expansion and acquisitions. But we also want to invest in our employees. ***Our board of directors has approved a recommendation to pay a bonus of US $500 to every employee globally****. The bonus will be paid to all employees employed as of December 31, 2017 (other than the Corporate Leadership Team) and will be included in a January 2018 payroll. Management and the Board value each of you and your contributions, and this bonus is one way we wish to show our appreciation for your contributions to our strong business performance and excellent execution.*

I look forward to working with all of you to create great future of continued growth for Bio-Techne. On behalf of the entire management team, thank you. – ***Dec. 21, 2017 special message to employees from Bio-Techne CEO Chuck Kummeth***

Best Buy (Richfield, Minnesota) -- $1,000 bonuses for full-time employees; $500 bonuses for part-time employees. Over 100,000 employees nationwide will receive bonuses:

Best Buy is the latest major corporation to hand out bonuses to its employees as a result of the recently passed corporate tax reform.

In a letter sent to employees Friday afternoon, CEO Hubert Joly said full-time employees will receive a one-time bonus of $1,000 and part-time employees $500.

All permanent employees who are not on an existing bonus plan will receive the additional funds. The bonuses are expected to show up in their paychecks this month.

In all, more than 100,000 of Best Buy's 125,000 employees in the U.S., Mexico and Canada are slated to receive the extra payouts.

In addition, Best Buy is making a one-time contribution of $20 million to the Best Buy Foundation to help further expand its teen tech centers and Geek Squad Academies across the U.S.

"Our goal was simple: to say 'thank you' to more than 100,000 of our employees and help accelerate our work to bring much needed technology training to 1 million underserved teens a year," said Jeff Shelman, a Best Buy spokesman.

In recent days, other major retailers including Lowe's, Home Depot and Walmart have also said they will hand out bonuses, expand benefits, and raise wages of its workers in light of the tax reform.

In Minnesota, U.S. Bancorp and TCF Financial also are handing out bonuses to workers and increasing charitable donations. U.S. Bank also said it would raise the minimum wage of its hourly employees to $15.

*Among other changes, the new tax law cut the top federal tax rate for corporations from 35 percent to 21 percent."—**Feb. 2 2018, Minneapolis Star Tribune***

Hormel Foods Corp. (Austin, Minnesota) – Stock options for employees; increased base wage to $13 per hour:

*Hormel Foods Corp. this morning announced that it plans to use savings from the federal Tax Cuts and Jobs Act to award stock options to its employees and raise starting wages to $13 an hour. — **Feb. 22, 2018 Post-Bulletin article excerpt***

TCF Financial Corporation (Wayzata, Minnesota) -- $1,000 bonuses for full time employees; $500 bonuses for part time employees (exact number receiving bonus unknown at this time):

*"As a result of the Tax Cuts and Jobs Act, TCF will provide approximately $5 million in one-time bonuses to eligible team members—$1,000 to full-time team members and $500 to part-time team members—who earned less than $100,000 in total compensation during 2017, totaling 80 percent of its workforce. Additionally, TCF will donate $5 million to TCF Foundation to increase grants to nonprofit organizations in the communities it serves, including increasing its match of team member contributions to nonprofit organizations from 100 percent to 200 percent in 2018." – **Friday Dec. 29, 2017 TCF Financial Corporation press release***

Data Sales Co., Inc. (Minneapolis, Minnesota) – $1,000 bonuses for all 80 employees:

*Data Sales Co., Inc. announced today that the Company will **celebrate the recent passage of tax reform legislation by distributing to all 80 plus employees a special bonus of $1,000 each.** Data Sales Co. will benefit from the new tax law lowering the corporate tax rate from 35 percent to 21 percent:*

"Our hard-working employees make this company succeed, and we wanted them to share in the savings the company will see and also help grow our economy. Today I'm announcing that every employee will receive a cash bonus of $1,000 each," said Paul Breckner, President of Data Sales Co. "I also want to thank our local Congressman, Jason Lewis, for his consistent advocacy of tax reform and seeing it through to becoming law. With the majority of our 80+ strong workforce here in Burnsville, I'm pleased that the benefits of tax reform will be felt at home."

Background on tax reform bonuses and Data Sales Co.:

All employees, whether full-time or part-time, hourly, salaried, commission or non-commission *will receive the bonus to show our appreciation and heartfelt thanks for their service. We believe this tax reform will be good for Data Sales, spur economic growth, continue to grow jobs and keep unemployment at an all-time low. –* ***Jan. 22, 2018 Data Sales Co., Inc. press release***

DTN (Burnsville, Minnesota) -- DTN an independent provider of information and actionable insights in the areas of agriculture, transportation and energy, and publisher of The Progressive Farmer, gave $1,000 bonuses to nearly 700 employees.

Ecolab Inc. (St. Paul, Minnesota) – $25 million in charitable donations:

> ***In response to the passage of the new U.S. tax law, Ecolab announced its intent to make a $25 million contribution to the Ecolab Foundation.*** *Since 1986, the Ecolab Foundation has contributed more than $100 million to communities in which we do business by providing basic needs, including hunger relief and affordable housing; supporting education, the arts and environmental conservation; as well as providing support to global relief organizations during times of natural disasters. –* ***Jan. 23, 2018 Ecolab Inc. press release***

T.J. Maxx – 16 stores in Minnesota – tax reform bonuses, retirement plan contributions, parental leave, enhanced vacation benefits, and charitable donations:

> *The 2017 Tax Act benefited the Company in the fourth quarter and full year Fiscal 2018. The Company expects to continue to benefit from the 2017 Tax Act going forward, primarily due to the lower U.S. corporate income tax rate. As a result of the estimated cash benefit related to the 2017 Tax Act, the Company is taking the following actions:*
>
> ***Associates***
>
> - *A one-time, discretionary bonus to eligible, non-bonus-plan Associates, globally*
> - *An incremental contribution to the Company's defined contribution retirement plans for eligible Associates in the U.S. and internationally*
> - *Instituting paid parental leave for eligible Associates in the U.S.*
> - *Enhancing vacation benefits for certain U.S. Associates*
>
> ***Communities***
>
> *Made meaningful contributions to TJX's charitable foundations around the world to further support TJX's charitable giving. –* ***Feb. 28, 2018 The TJX Companies Inc. press release excerpt***

Apple (There are five Apple stores in Minnesota: Bloomington, Edina, Minneapolis, Minnetonka, Roseville) -- $2,500 employee bonuses in the form of restricted stock units; nationally, $30 billion in additional capital expenditures over five years; 20,000 new employees will be hired; increased support of coding education and science, technology, engineering, arts, and math; increased support for U.S. manufacturing.

AT&T – Over 1,500 Minnesota employees received $1,000 bonuses; nationally, $1 billion increase in capital expenditures.

Bank of America (Multiple locations in Minnesota) -- $1,000 bonuses.

Chipotle Mexican Grill (Multiple locations in Minnesota) – Bonuses ranging from $250 to $1,000; increased employee benefits; nationally, $50 million investment in existing restaurants.

Cintas Corporation (Multiple locations in Minnesota) -- $1,000 bonuses for employees of at least a year, $500 bonuses for employees of less than a year.

CVS Health (Multiple locations in Minnesota) -- Base wage raised to $11 per hour, and other pay ranges adjusted accordingly; company will absorb increases costs of health insurance premiums; creation of new parental leave program.

Comcast (Multiple locations in Minnesota) -- $1,000 bonuses; nationally, at least $50 billion investment in infrastructure in next five years.

Home Depot (Multiple locations in Minnesota) -- Bonuses for all hourly employees, up to $1,000

Lowe's -- 1,000 employees at 11 stores in Minnesota. Bonuses of up to $1,000 based on length of service; expanded benefits and maternity/parental leave; $5,000 of adoption assistance.

Ryder (Six locations in Minnesota) – Tax reform bonuses for employees totaling $23 million nationwide.

Taco John's (63 locations in Minnesota): All full-time and part-time crew members received a $200 after-tax bonus:

> *Taco John's International, Inc. announced today that in response to the 2018 Tax Cut and Jobs Act, the company gave part of its projected tax savings to its restaurant crews, general managers, corporate staff and CORE (Children of Restaurant Employees).*
>
> *On Friday, Feb. 23, Taco John's International, Inc.'s employees received a one-time bonus, as follows:*
>
> - *Every restaurant crew member - full-time and part-time - received $200 (after taxes);*
> - *General managers and employees at the Taco John's Franchisee Support Center in Cheyenne received $1,000 each; and,*
> - *The Executive Council of Taco John's International, Inc. (Vice Presidents and above) donated their $1,000 bonuses (a total of $10,000) to CORE, a national not-for-profit organization that grants support to children of food and beverage service employees who are navigating life-altering circumstances.*
>
> *"At Taco John's International, our team is our family, so sharing the financial benefits that were a result of the recent tax reform legislation only makes sense," said Jim Creel, CEO of Taco John's International, Inc. "We encourage other restaurant brands to follow our example and give a portion of their savings to the people that are at the heart of what we do and to great organizations like CORE that support our crew. One hundred percent of CORE's funds directly benefit children of restaurant employees who have been afflicted with life-threating conditions."*
>
> *"We are so grateful to the Taco John's team for their generous donation to our CORE family members," said Lauren LaViola, executive director of CORE. "Donations like theirs help us provide for our food and beverage service families experiencing loss, illness and other life-changing circumstances, and help us get closer to our goal of helping even more families across all 50 states in 2018."*

The total amount that Taco John's International, Inc. gave exceeded $150,000.00. – ***Feb. 28, 2018 Taco John's International, Inc. press release***

Starbucks Coffee Company (Multiple locations in Minnesota) – $500 stock grants for all Starbucks retail employees, $2,000 stock grants for store managers, and varying plant and support center employee stock grants, totaling more than $100 million in stock grants nationwide; 8,000 new retail jobs and 500 new manufacturing jobs; an additional wage increase this year, totaling approximately $120 million in wage increases, increased sick time benefits and parental leave.

U-Haul (Multiple locations in Minnesota) – $1,200 bonuses for full-time employees, $500 bonuses for part-time employees.

Wal-Mart – 68 locations in Minnesota; Base wage increase for all hourly employees to $11; bonuses of up to $1,000; expanded maternity and parental leave; $5,000 for adoption expenses.

Waste Management, Inc. (Multiple locations in Minnesota) -- $2,000 bonuses.

Wells Fargo – 150 bank locations in Minnesota -- Base wage raised from $13.50 to $15.00 per hour; nationally, $400 million in charitable donations for 2018; $100 million increased capital investment over next three years.

Anthem (Multiple locations in Minnesota) -- Nationally, $1,000 in extra 401(k) contributions for 58,000 employees.

3M

3M said its tax rate under the new "Tax Cuts and Jobs Act" will fall to 20 percent to 22 percent in 2018, down from a prior rate of 26 percent to 27 percent. Executives said they will use the savings to boost returns for shareholders, increase pension reserves and to invest in the company.

With the savings, executives said the company's 2018 full-year profit will be in a range of $10.20 to $10.70 a share, up from its prior guidance of $9.60 to $10. The company finished 2017 with a full-year profit of $7.93 a share, or $9.17 a share excluding the tax-related charge.

The company's board approved a 16 percent increase in shareholder dividends for the first quarter of 2018. During the fourth quarter of 2017, 3M paid shareholders $699 million in dividends and repurchased $504 million of its own shares. 3M also contributed $600 million to its U.S. pension plan.
***Minneapolis Star Tribune* January 25, 2018**

Northwestern | Kellogg School of Management

WRITTEN STATEMENT

BEFORE THE UNITED STATES CONGRESS JOINT ECONOMIC COMMITTEE HEARING ON "THE POSITIVE ECONOMIC GROWTH EFFECTS OF THE TAX CUTS AND JOBS ACT"

September 6, 2018

Benjamin Harris

Kellogg School of Management

I'd like to start this testimony by thanking Chairman Paulsen, Ranking Member Heinrich, and all members of the Joint Economic Committee for inviting me to testify at this important hearing on the topic of taxes and economic growth. It is an honor to receive this invitation.

In addressing the projected economic effects of the Tax Cut and Jobs Act of 2017 (TCJA), my testimony focuses on three main points:

(1) The TCJA is poorly designed to spur new investment in a cost-effective way, providing massive windfall gains to investors and driving down certain types of investment;
(2) The TCJA exacerbates a deteriorating fiscal outlook which will in all likelihood eventually hurt the wellbeing of middle-class families; and
(3) The TCJA is poorly designed to raise wages and benefit workers.

After summarizing the tax cut and reviewing independent estimates of the legislation, I elaborate on these points while also raising several other concerns.[1]

I. Summary of the TCJA

The TCJA is an exceptionally broad and complex piece of legislation, implementing major changes in the corporate, individual, and estate tax codes. While the TCJA makes dozens of changes to various aspects of business taxation, the major elements can be summarized in four

[1] Much of this testimony is drawn from a co-authored paper with Adam Looney (Harris and Looney 2018) titled "The Tax Cut and Jobs Act: A Missed Opportunity to Establish a Sustainable Tax Code"; the paper is available here: https://www.brookings.edu/wp-content/uploads/2018/05/es_20180524_harris-looney_taxreform.pdf. The views expressed are my own and should not be attributed to Kellogg School of Management or Northwestern University.

key changes. One, steep and permanent cuts in the top corporate tax rate from 35 percent to 21 percent. Two, a temporary expansion of expensing provisions, allowing for temporary accelerated write-offs for machinery and equipment, offset by scaling back of some business tax benefits. Three, substantial changes to the system of taxing multinational corporate activity abroad, including elimination of the tax on repatriated dividends, a new minimum tax on intangible profits in low-tax countries, an anti-base erosion tax, and a one-time transition tax on pre-existing foreign earnings. Four, a new and complicated tax deduction on profits for the owners of pass-through businesses, such as partnerships, S corporations, and limited liability corporations.

The individual side includes five major elements. One, temporarily lower statutory tax rates through 2025 and, due to changes to the indexing formula, higher tax burdens thereafter. Two, temporary elimination of personal exemptions in return for a larger standard deduction and a more generous Child Tax Credit with expanded eligibility. Three, temporary limits on certain kinds of itemized deductions, including a lower limit on the size of a mortgage that generates deductible interest, a $10,000 annual limit on deductible state and local taxes, and the elimination of the deduction for miscellaneous itemized deductions. Four, a temporarily higher Alternative Minimum Tax exemption. Five, permanent elimination of the penalty for not obtaining health insurance. All of the temporary provisions expire after 2025.

The bill also shrinks the estate tax by approximately doubling the estate tax exemption to roughly $20 million per couple, with conforming changes to the gift tax. This provision also expires after 2025.

II. Economic analysis of the TCJA

A collection of independent entities have evaluated and projected the economic impact of the bill. Overall, these entities typically project TCJA to boost economic activity initially, but slow the growth rate of the economy in later years. In the first few years, lower corporate and business taxes, temporary expensing of investment, and lower rates on individuals increase investment and labor supply. Over time, however, rising interest rates due to growing deficits and the expiration of temporary tax cuts drags down economic growth. In addition, the legislation drives up borrowing from abroad, giving foreign investors a larger claim on domestic income—leaving national income earned by Americans little changed by 2028. For example, the Congressional Budget Office (CBO) projects that the TCJA will grow Americans' inflation-adjusted income by just 0.1 percent after 10 years, while leaving our nation in a markedly worse fiscal position.

All told, the bill sharply cuts tax rates on capital. Accounting for the various impacts, CBO estimates the business reforms lower the marginal tax rate on capital by 1.5–3.4 percentage points in the budget window (CBO 2018b)—with the most pronounced impacts coming in 2020 and 2021, leveling off around 1.5 percentage points in 2027 and 2028. As discussed below, these changes in marginal tax rates on capital, coupled with other changing incentives, produce markedly different impacts on various types of investment, with equipment and non-residential structures generally benefitting and intellectual property and residential structures suffering.

As with capital, the TCJA's impact on labor income varies over time. Over the first eight years of the budget window, the temporary tax cuts on individual income boost labor supply, while their expiration and permanent changes in price indexing more than reverse the initial boost. The impacts of tax rate cuts are also balanced against idiosyncratic changes that offset the benefit of the individual cuts, including the limits on deductions for mortgage interest and state and local taxes, higher taxes imposed on compensation over $1 million paid to certain employees, and the repeal of deductions for unreimbursed employee business expenses. With the expiration of the individual income tax cuts in 2025, the positive impacts of the bill on labor supply dissipate. All told, marginal tax rates on labor are a few percentage points lower in the initial years, but are then slightly higher in the years following the expiration of the cuts.

The plan does little to permanently broaden the tax base. On the individual side, the increases in the Child Tax Credit and expanded standard deduction offset the repeal of personal exemptions. The plan makes judicious changes to the mortgage interest deduction and places limits on state and local tax deductions. On the business side, the tax base is narrowed both by the new pass-through business deduction, new deductions for intangible income and the shift to a territorial tax system, and the extension of expensing and expansion of favorable accounting treatment to businesses. These changes are partially offset by limitations on interest expense and NOL deductions, and the new minimum tax on global intangible income.

The economic efficiency of these changes in business tax expenditures is uncertain; while the new tax breaks encourage certain types of new investment, the limitations on interest deductibility and NOLs raise taxes elsewhere and discourage risk taking and entrepreneurial activities. Many of the largest tax expenditures are left untouched, including the exclusion of employer-provided health insurance, deferred taxes on retirement contributions, and preferential rates on investment income.

Lower rates and the little-changed tax bases means the bill sharply increases deficits and the cumulative public debt. CBO estimates that the deficit as a share of GDP will rise to 5.4 percent in 2022, compared to a 50-year average of 2.9 percent. As a consequence, public debt as a share of GDP is projected to rise an additional 6 percentage points by 2028 (CBO 2018a). These new additions to near-term deficits exacerbate an already precarious long-term debt trajectory. For example, Auerbach, Gale, and Krupkin (2018) show that stabilizing the debt-to-GDP ratio at its current level requires shrinking the deficit by 4 percent of GDP—equal to an immediate (and permanent) increase in revenues of 24 percent (or shrinking spending by 21 percent).

Higher deficits and rising debt will push up interest rates, crowd-out private investment, and increase borrowing from abroad. Claims that the revenue lost from the bill would be replaced by economic growth are greatly exaggerated, with CBO (2018b) estimating that the bill would generate just $461 billion in deficit reduction through economic growth. Put differently, just 20 percent of the $2.3 trillion revenue cost would be offset.[2] Because private capital investment is more productive than public consumption, higher deficits crowding out private capital investment lowers long-term growth. Thus, the effects of crowd-out peak in 2022, when the impact of rising federal deficits reaches its high point. CBO (2018b) puts the reduction in private investment from crowd-out at approximately $60 billion.

As a result of these shortcomings, most independent analyses find the bill will have only modest effects on economic growth. Macroeconomic analysis from CBO found that the average change in key macroeconomic variables—the capital stock, employment, and most importantly, output—would all rise by less than 1 percent throughout the budget window.[3] The moderate declines in statutory tax rates, in part because of the corresponding limits on itemized deductions and the impact of bracket creep due to indexing for inflation using the chained CPI, ultimately only reduce marginal tax rates on wages by less than 2 percentage points—with changes effectively falling to zero after the expiration of the cuts in 2025 (CBO 2018b). Between tepid effects on growth and the increase in borrowing from abroad, gross national product—income earned by Americans—is little changed in 2028.

Analysis by academic economists have reached similar conclusions. A recent paper by Barro and Furman (2018) utilizes a standard neoclassical to model the macroeconomic impacts of the TCJA. Under their analysis, the tax cut primarily impacts the economy through reductions in the user cost of capital, which will lead to changes in the aggregate stock of capital in the economy. Barro and Furman find that the impacts of the tax cut are positive, but generally modest at best. Barro and Furman estimate that the tax law boosts GDP by 0.4 percent over a decade if higher interest rates don't crowd-out investment and by just 0.2 percent if it does.[4] Under a scenario where the provisions of the tax cut are made permanent, the 10-year GDP impact is 1.2 percent assuming no crowd-out effects and 1.0 percent incorporating crowd-out. These growth levels imply 10-year average annual growth impacts of between 0.02 percent and 0.13 percent.

Table 1. 10-Year Growth Estimates of Tax Cuts and Jobs Act

		Legislation as Enacted	Provisions Become Permanent
10-year change in GDP	without crowd-out	0.4%	1.2%
	with crowd-out	0.2%	1.0%
10-year change in GDP, annualized	without crowd-out	0.04 percentage points	0.13 percentage points
	with crowd-out	0.02 percentage points	0.10 percentage points

Source: Barro and Furman (2018).

[2] The $571 billion in additional revenue is offset by a $110 billion increase in the cost of servicing the increase in debt.
[3] Specifically, private non-residential fixed investment, employment, and overall output would be 0.3, 0.6, and 0.7 percent higher through the 10-year budget window (CBO 2018b).
[4] Barro and Furman model interest rate changes based on Laubach (2009) which assumes that a 1 percentage point increase in the unified deficit (as a share of GDP) raises interest rates by 25 basis points.

Analysis of the TCJA by other research institutions also find small growth effects in the 10-year budget window. Comparing various organization's projected growth impacts shows a remarkably similar pattern (CBO 2018b, see Table 2 below). Virtually all of the projections find the 10-year impact on the level of GDP to be less than 1 percent—with the lone exception being the conservative Tax Foundation estimates. (The International Monetary Fund found that the tax cut would slightly shrink the economy after ten years, all others found positive impacts.) Almost all organizations find a moderate uptick in the level of GDP in the initial years, following by negative or subdued growth between 2020 and 2022.

Table 2. Assorted Estimates of the Effects of the 2017 Tax Act on the Level of Real GDP

	First Five Years					Tenth Year	Average		
	2018	2019	2020	2021	2022	2027	2018–2022	2023–2027	2018–2027
Moody's Analytics	0.4	0.6	0.2	0.1	0	0.4	0.3	0.3	0.3
Macroeconomic Advisers	0.1	0.3	0.5	0.6	0.6	0.2	0.4	0.5	0.5
Tax Policy Center[a]	0.8	0.7	0.5	0.5	0.5	*	0.6	0.3	0.5
International Monetary Fund	0.3	0.9	1.2	1.2	1	-0.1	0.9	0.3	0.6
Joint Committee on Taxation	–	–	–	–		0.1 to 0.2	0.9	0.6	0.7
Congressional Budget Office	0.3	0.6	0.8	0.9	1	0.6	0.7	0.8	0.7
Goldman Sachs	0.3	0.6	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Tax Foundation	0.4	0.9	1.3	1.8	2.2	2.9	1.3	2.9	2.1
Penn Wharton Budget Model	–	–	–	–	–	0.6 to 1.1		–	–
Barclays	0.5	–	–	–	–	–	–	–	–

[a] Values are for fiscal years.
GDP = gross domestic product; – = notavailable; * = between -0.05 percent and zero.
Source: CBO (2018b).

Moreover, focusing on GDP overstates the boost to American's incomes from the TCJA because much of the new activity will benefit foreign investors. As Gale and Page (2018) explain, lower taxes on corporations and capital investments will encourage additional capital investment, but most of that new capital will be financed by foreigners. As a result, payments to foreign owners—interest, dividends, or corporate profits—will rise. They note that while CBO's projection of production within U.S. borders will increase by 0.5 percent by 2028, the projected income accruing to Americans will barely rise. After accounting for the depreciated capital owned by Americans, the net change in real income for Americans is projected to be effectively zero after ten years.

Beyond its aggregate effects, the bill has uneven effects across sectors. Increases in marginal tax rates in high-tax states (because of the limit on the deductibility of state and local taxes) and implicit reduction in the exclusion for municipal bond interest may shift the level and composition of subnational government spending and financing. The elimination of the penalty for not carrying health insurance will cause fewer healthy people to carry insurance and may increase cost of insurance for some groups. Changes to the use of itemized deductions will raise the after-tax cost of charitable giving and will shift incentives for homeownership (Gale *et al.* 2018).

Lastly, aggregate growth and sectoral impacts aside, the package also represents a shift in tax burden away from capital and towards labor. At 21 percent (plus shareholder-level taxes), the corporate burden is now below the combined payroll plus income tax rates applied to wage earners; for qualifying pass-through business owners, the rate can be much lower. In addition, with new limitations on the deductibility of executive compensation and a corresponding tax on tax-exempt entities, the top marginal rate on those wages exceeds 50 percent; unreimbursed business expenses are no longer deductible for employees; and state and local taxes remain deductible for corporate businesses, but are limited for wage earners. Hence, the bill encourages more of national income to accrue to businesses and less in the form of wages.

All told, the combined evidence on the growth impacts of the tax act suggest it will slightly grow the economy in the near-term, reduce growth over the longer term, and net out close to zero for income earned by Americans. While that conclusion varies slightly depending on modeling assumptions, all estimates suggest a small long-run impact. My view is that the TCJA provides too little boost to economic growth to offset the eventual pain that will come later with higher public debt. This is a missed opportunity to reform the individual and corporate tax codes. In an era of slowing economic growth, a more thoughtful reform could have provided a welcome lift to the trajectory of U.S. growth.

III. The primary economic shortcomings of the TCJA

My testimony below raises serious concerns with the legislation's ability to substantially raise economic growth over the medium- to long-term. From the outset, it is worth noting that economic growth is not the only consideration when evaluating the merits of a tax reform. In particular, a reform's impact on the progressivity of the tax code is also an important—and often well-studied—factor.

Independent analysis of the TCJA's relative impact on taxpayers of different income levels suggests that the cut will substantially weaken the progressivity of the tax code over time. For example, the independent and non-partisan Tax Policy Center (2017) found that by 2027, the TCJA will modestly lower after-tax income for middle-income households (with a tax increase of roughly $50), while raising income for the top 1 percent by 0.9 percent (with a tax cut of $20,660). The merits of such a shift depend on one's value judgement regarding the appropriate progressivity of the tax code and, more broadly, the level of income inequality in the economy. With that caveat, my testimony below will mostly ignore progressivity considerations and instead focus on the economic impact of the legislation.

(1) The TCJA is poorly designed to spur new investment in a cost-effective way, providing massive windfall gains to investors and driving down certain types of investment.

One of the most significant shortcomings of the TCJA is the large windfall gain provided to owners of already committed capital. In this context, windfall gains refer to tax cuts awarded to individuals and businesses for something they have already done. The corporate tax cut, which reduced revenues by $1.35 trillion over the budget window, is a classic example of a windfall gain. (Part of the corporate tax cut that reduces future taxes on new investment would not be classified as a windfall.) By reducing future tax rates, the TCJA increased the profitability of investments that have already been made—without requiring that corporations make any new investment. Since the aggregate economic growth owing to a tax cut is largely determined by its ability to raise investment or increase labor supply, windfall gains represent a wasted opportunity to boost the economy for the long-run. This shortcoming is one of the primary reasons why so many independent estimates project the Act to have a near-zero impact on growth.

To better understand why the TCJA has such limited growth impacts, it may be useful to compare the design of TCJA—a reform motivated by its purported economic effects—with idealized reforms studied in the economics literature. Economists have long-studied the economic impacts of major tax reforms that would fundamentally alter incentives for various factors of production and have profound impacts on capital and labor markets. A critical observation is that the pro-growth effects of fundamental tax reform are not about the level of tax revenues, but rather about the structure of the tax system. In particular, the benefits of fundamental reform, such as moving from an income tax to a consumption tax, reflect one fundamental element: using a tax on old capital to finance lower rates on wages and new investment.[5] Such reforms improve the prospects for both workers and active investors because they increase new investment, but without shifting the tax burden to workers. The losers in this scenario are the owners of already committed capital or investments earning economic rents who see their after-tax return decline.

The importance of the tax on old capital is widely recognized in the academic literature studying and simulating tax reform.[6] This literature examines an assortment of tax reforms using a wide variety of models, but the clear winners are those reforms that use the levy on existing capital to reduce rates on more productive activities. For instance, several papers attempt to model the effects of alternative tax reforms on economic growth, wages, and the wellbeing of workers (Altig *et al.* 2001; Fullerton and Rogers 1995; Elmendorf and Reifschneider 2002). Altig *et al.* (2001), for example, model a variety of reforms and offer the clearest hierarchy for ranking fundamental tax reforms. In their ranking, the *only* reform that is both pro-growth and net positive for middle-class wage earners is the X-Tax—a progressive consumption tax. In effect, the X-Tax uses the tax on old capital implicit in the business cash flow tax to provide expensing for new investment and lower the tax rate on wages. Taxpayers get the triple benefit

[5] While taxing old capital is sometimes viewed as applying a second (consumption) tax to income that has been previously subject to income or payroll tax, the reality is that a sizable share of income either avoids income tax or benefits from preferential rates.

[6] In testimony before Congress, Hassett (2012) reviews the economic literature on optimal taxation at length, observing that the strongest effects on economic growth derive from expensing of business investments, rather than reducing corporate taxes or taxes on capital gains.

of low tax rates, increased productivity, and progressive incidence—the primary cost of such reform is that investors on already-committed capital pay higher taxes (and receive lower profits) than initially anticipated.

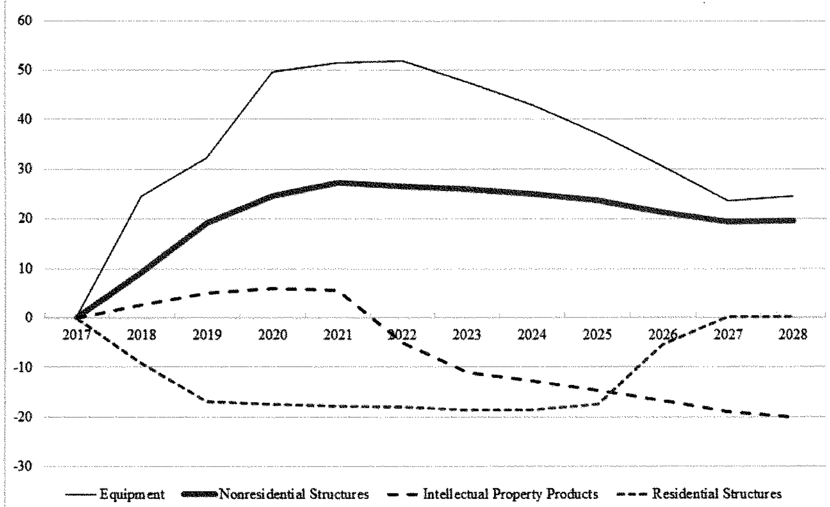
The key observation is that any new reform that provides windfall gains to already-committed capital must compensate for those gains in ways that will stunt growth. That makes it difficult for any reform that increases the reward for old capital to be growth enhancing. As a starting point, that suggests that reversing or recapturing the TCJA's windfalls should be a top priority.

For instance, there are good arguments that the reduction in the corporate rate to 21 percent went too far, and that instead raising the corporate rate to somewhere between this new low and the old rate of 35 percent has several advantages. First, the corporate tax system applies to a large share of income and produces substantial revenues, which cannot be replaced without imposing new taxes elsewhere in the economy. Second, it is progressive with almost 70 percent of its burden falling on high-income taxpayers (Cronin *et al.* 2013). Third, setting the total tax rate on corporate (or business) income at or above the top rate on wages is a substantial source of simplification because it encourages most labor income to be paid out as wages (rather than retained as profits). That treatment largely eliminates inefficient tax sheltering and tax avoidance behaviors, and reduces the need for complex and onerous rules differentiating each type of income. Raising the U.S. corporate rate to the range of 25 to 28 percent would remain comparable to peers in developed economies, but the effective tax rates on new investments would be far lower because domestic investments could benefit from R&E credits and expensing of investment.

Similarly, windfall gains to non-corporate capital owners could also be reversed by eliminating the newly-enacted pass-through deduction. From the perspective of simple, efficient, and fair tax policy, the single worst change in the entire legislation is the reduced rate on qualified pass-through business income because it reduces progressivity, picks winners among businesses, increases complexity, and exacerbates domestic distortions, all while cutting revenues.

A related concern with the TCJA is that, while it does boost aggregate investment (albeit in an exceptionally costly way), the tax act will actually *reduce* certain types of investment. In particular, the TCJA will lower total investment in both residential real estate and investment in intellectual property. The reduced investment in residential real estate—owing largely to reduced ability to deduct housing-related itemized deductions— is estimated by CBO to amount to nearly $20 billion less in investment annually from 2019 through 2025. Similarly, changes in the treatment of depreciation for R&D and software development beginning in 2022 mean that investment in intellectual property will fall by nearly $20 billion annually in 2022 through the end of the budget window.

Effects of TCJA on Investment Through Changes in Incentives (\$billions)



Source: CBO (2018b).

(2) The TCJA exacerbates a deteriorating fiscal outlook which will in all likelihood eventually hurt the wellbeing of middle-class families.

As members of this committee are well-aware, our nation faces serious long-term fiscal challenges. The Congressional Budget Office recently projected that the public debt as a share of GDP would reach 152 percent in 2048. These projections, however dire, may actually understate the magnitude of our country's long-run fiscal imbalance. For example, a study I published with co-authors Alan Auerbach and William Gale projected that the debt-to-GDP ratio would exceed 180 percent of GDP by 2040 if our country fails to adequately contain growth in health care costs (Auerbach, Gale, and Harris 2014). Lower-than-projected economic growth, additional unpaid-for tax cuts, higher levels of public spending, and weakened tax compliance could all lead to higher deficits over time.

The consensus among economists is that the TCJA starkly increased short-run deficits and public debt.[7] Independent estimates of the cost of the TCJA, even when incorporating

[7] In a University of Chicago survey of prominent economists regarding whether the tax plan would "substantially" increase the debt-to-GDP ratio after a decade, 45 percent of respondents strongly agreed, 43 percent agreed, and 2 percent were uncertain.

dynamic feedback, put the combined fiscal impact at around $2 trillion over the budget window, when the interest costs of additional borrowing are added to the lost revenue owing to the tax cut.

Despite these soaring costs, CBO estimates may actually understate the magnitude of the legislation's impact on deficits and accumulated debt. This is because the TCJA's sweeping cuts to the individual income, corporate, and estate tax rates are partially financed by shrinking selected tax expenditures or eliminating certain deductions, but also by provisions that raise revenue in the budget window but actually worsen long-term deficits. In particular, the one-time repatriation on deferred foreign income and the zeroing of the Affordable Care Act shared responsibility tax each raise roughly $300 billion over the 10-year budget window, but worsen deficits in the long-run.

And the cost of the legislation rises if the expiring provisions are assumed to be permanent. According to CBO, extending the provision that allows businesses to immediately deduct the cost of their investments—which expires in 2022—would increase deficits by $122 billion over the 2019–28 period. Extending expiring individual income tax provisions and the increase in the estate and gift tax exemption would add another $650 billion to the cost. Along with extensions of several smaller non-TCJA tax provisions, and postponement of healthcare taxes, this alternative fiscal scenario increases the federal debt by an additional $1.2 trillion by 2028. This would place federal debt at 105 percent of GDP that year, its highest level since World War II.

These soaring deficits will eventually have deleterious economic and social impacts—although the nature of impact depends on the eventual response by Congress. Here I address two potential outcomes: one where Congress responds by extending the tax cuts without a simultaneous change in spending, and another where steep cuts lead to marked reductions in social programs such as Social Security and Medicare. Congress could also respond by raising future revenue or by cutting discretionary spending; the impact of these scenarios would depend precisely on the nature of the policy response. It should be noted, however, that non-defense discretionary spending has already been driven near historic lows as a result of the Budget Control Act of 2011 and the subsequent failure of the Joint Select Committee on Deficit Reduction, which resulted in automatic cuts to most discretionary spending programs.

Under a situation where debt as a share of GDP continually grows, we will likely see sharply increased interest rates—which will crowd out private investment and increase the cost of borrowing for homeowners, student loan recipients, small business loan holders, and consumers of all stripes. Unfortunately, the risks of this scenario are compounded by the potential for dramatically higher debt to destabilize the financial sector. This timing of this situation is difficult to predict as U.S. publicly held debt well in excess of 100 percent of GDP is unprecedented in the modern economy.

An alternative scenario is one in which policymakers attempt to avoid a future debt crisis by cutting major public programs, such as Social Security and Medicare. As Social Security is the bedrock of the U.S. retirement system, any systematic and widespread reductions in benefits would have marked implications on the wellbeing of American retirees. Roughly half of elderly households rely on Social Security for all or nearly all of their retirement income, while another quarter of elderly households depend on Social Security benefits for a substantial portion of their income. For these households, cuts in Social Security benefits would result in a severe deterioration in their standard of living.

Medicare is nearly as important as Social Security to the livelihood of American retirees. In 2018, the current Medicare expenditure per beneficiary is $13,576; any substantial cuts to Medicare that are not paired with cost-reduction reforms would be detrimental to the wellbeing of millions of retirees. Likewise, while Medicaid benefits are less universal than Medicare, they are still crucial for those Americans requiring long-term care. In recent years, nearly half of all long-term care costs for elderly individuals were paid by Medicaid. Sharp cuts in either of these programs would undoubtedly harm older Americans, many of whom cannot plausibly return to the labor market and who have limited assets. For these lower-income retirees, cuts in public programs may result in difficult choices between paying for medical care and purchasing basic necessities, like housing, clothing, and food.

(3) The TCJA is poorly designed to raise wages and benefit workers.

In broad terms, there are two primary ways that tax reform (or tax cuts) can increase after-tax wages. One is by increasing pre-tax wages by raising worker productivity through the provision of higher business investment. Under this scenario, tax reforms that boost investment can eventually lead to higher wages by first increasing the level of investment, which can then boost worker productivity, which can then theoretically raise wages. There are plenty of caveats to this situation, including the weakened link between productivity and real wage gains since the mid-1970s and increasing concern over limited labor market competition. Importantly, too, under this scenario only a small fraction of each dollar of foregone business tax revenue would eventually be recaptured in higher wages—organizations that project the economic impact of tax cuts typically put the incidence of the corporate tax on labor at around one-fifth.

A second way that tax legislation can increase after-tax return to work is by directly cutting the tax on wages. The most direct way to achieve this is through a payroll tax cut, as that tax only applies to wage income (as opposed to the income tax, which applies to both wages and other forms of income). If the purpose of a tax cut is to boost workers' wages, it is difficult to conceive of a more direct and effective approach than a reduction in the worker's share of the payroll tax—either by directly cutting the tax or by providing a refundable tax credit based on payroll taxes paid. For example, in 2010 the employee-side payroll tax was reduced by 2 percentage points for two years; this cut had similar economic impacts as the Making Work Pay Tax Credit, which was effectively a rebate up to $800 ($400 for single filers) on payroll taxes paid. Making the Earned Income Tax Credit more generous is an attendant strategy if the goal of tax reform is to boost after-tax return to work for lower-income workers.

Tax reform can also boost incomes through more targeted reductions in tax rates on wage income. In particular, reforms that reduce effective marginal tax rates—which include the effects of both taxes and transfer programs—can increase incentives for non-workers to enter the workforce and for current workers to supply more labor. Tax rates can be exceptionally high for subsets of workers, especially those who are in the phase-out range for various programs—such as the Earned Income Tax Credit and Supplemental Nutrition Assistance Program benefits.[8]

Unfortunately, the TCJA receives poor marks on these various criteria. As described above, a necessary condition for the TJCA to boost wages through higher investment is that investment must itself rise to a higher level than would have occurred in the absence of the legislation (i.e., simply observing that investment is rising or falling is insufficient to make the case that the changes are caused by the tax change). Future academic studies will shed light on the effect of the TCJA on various types of investment, but initial evidence suggests that it has yet to have an impact.

A recent presentation by Jason Furman, Professor of Practice at the Kennedy School of Government, suggests that investment has yet to respond to the legislation. For example, Furman showed that several measures of investment—including new orders of non-defense capital goods, the ISM Manufacturing New Orders Index, and the Future Capital Expenditures Diffusion Index—started rising in 2016 before the tax cuts could be anticipated and are actually flat or down since the Act's passage. In addition, the massive rise in buybacks—which, according to Goldman Sachs, are on pace to increase by nearly 50 percent in 2018 to roughly $1 trillion—suggests that companies are devoting their lower tax bills to share purchases rather than new investment. These preliminary observations, coupled with the observed stagnation in wages since the passage of the TCJA, strongly suggests that wage gains owing to productivity enhancements have yet to occur.

The TCJA is poorly targeted at labor income, with a large share of the cuts directed at lowering corporate tax burdens, and the TCJA is especially stingy when it comes to cuts on labor income for low- and middle-income taxpayers. While the new tax expenditure for pass-through businesses will likely benefit those with the ability to restructure their labor income, and the cuts in income tax rates are most beneficial to those at higher income levels, the TCJA's cuts provide relatively limited relief to millions of working families in the initial years of the cut. With the expiration of the income tax cuts in 2025, and the permanently higher indexing rates, tens of millions of working families will see tax increases beginning in 2026 and continuing indefinitely.

Lastly, not only does the TCJA's expiration mean that the average tax burden will rise for low- and middle-income families, but higher marginal tax rates on labor income will serve as a disincentive for working age Americans to enter the work force or to work more hours. CBO's projections estimate that marginal tax rates on labor will rise beginning in 2026, offsetting over time any gains made from the initial and temporary cut. The magnitude of this impact will depend on the eventual response by Congress, but the current tax code will increasingly serve as a barrier to work if the existing shortcomings are not repaired.

[8] For example, CBO (2015) found that "When federal payroll taxes, state income taxes, and benefits from SNAP and the cost-sharing subsidies for health insurance are included, the marginal tax rates are much higher: Only 16 percent of taxpayers will face marginal tax rates between 10 percent and 19 percent, and 78 percent will face higher rates. More than half will face marginal tax rates between 20 percent and 39 percent."

IV. Conclusion

The TCJA is one of the most consequential pieces of tax legislation in decades. However, there is often a stark discrepancy between consequential and beneficial. Estimates from a wide range of independent institutions project that, after a decade, national income will be largely unchanged, while American taxpayers will face an additional $2 trillion in debt. In my opinion, if Congress elects to take on such a large increase in debt for future generations, there are far more productive outlets than the tax cut that passed last December.

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RESPONSE FROM DR. DUNKELBERG TO QUESTIONS FOR THE RECORD SUBMITTED BY CHAIRMAN PAULSEN

A Council of Economic Advisers report, released September 5, 2018, found that properly measured, Q2–2018 inflation-adjusted hourly compensation of workers was 1.4 percent higher than a year ago. This compares with a 0.1 percent increase TCJA critics frequently tout. In your capacity as an economist, could you comment on this report's findings? Which indicators would be best to look at to determine what's really happening to workers' inflation-adjusted wages?

There are many measures of inflation and of wage and compensation gains over different time periods to analyze these numbers, producing different results. The Atlanta Federal Reserve has a good series that monitors wage changes for people who are in the same job from period to period. In this tight labor market, more people change jobs to earn more or get a preferable position. This signals gains for those switching. NFIB members have reported record-high percentages raising "compensation," which includes benefits and wages. The CEA analysis is certainly supported by the broader evidence such as NFIB findings, JOLTS reports (lots of turnover), and the Atlanta Federal Reserve. And, as I pointed out in testimony, such criticism ignores the fact that millions of new workers went from "zero" income to a positive income, a rather significant increase. But, for example, the 200,000 new job holders last month are added to the denominator to calculate "average wages." What they add to the numerator, total new wages, depends on what types of jobs they take. If they take exactly the same jobs that the existing workforce has, there is no change in "average wages," which explains the claim of "no gain" even though 200,000 more people are working and have an income.

Thank you for the opportunity to present the NFIB results at your hearing.

RESPONSE FROM DR. DUNKELBERG TO QUESTIONS FOR THE RECORD SUBMITTED BY RANKING MEMBER HEINRICH

Gross Domestic Product is the most commonly used indicator to measure the health of the overall economy. But it doesn't tell us how growth is shared across the economy—in other words, who is benefiting and who is not. To get a more complete and timely picture, we need to measure how economic growth is distributed across households. That's why I'm introducing legislation that instructs the Bureau of Economic Analysis to start reporting on new Income Growth Indicators (IGI), which would show how incomes are growing at different levels of income.

Do you believe that having more detailed and timely data on who is benefiting from growth would allow policymakers to better evaluate the long-term impact of the recent tax cuts as well as other policies?

The distribution is a very important dimension of our "economic performance," and I think that policymakers have access to those data at their discretion from Census and the Treasury Department. Organizations such as Brookings and Heritage pay attention to the distribution of income (and the distribution of spending by consumers) in their policy research. Perhaps the information could be more widely publicized. Reports of income shares by income decile are regularly produced and are available on the websites of the various agencies (HHS, Treasury, and Census).

Thank you for the opportunity to present the NFIB results at your hearing.

RESPONSE FROM DR. HARRIS TO QUESTIONS FOR THE RECORD SUBMITTED BY RANKING MEMBER HEINRICH

Gross Domestic Product is the most commonly used indicator to measure the health of the overall economy. But, it doesn't tell us how growth is shared across the economy—in other words, who is benefiting and who is not. To get a more complete and timely picture, we need to measure how economic growth is distributed across households. That's why I'm introducing legislation that instructs the Bureau of Economic Analysis to start reporting on new Income Growth Indicators (IGI), which would show how incomes are growing at different levels of income.

Do you believe that having more detailed and timely data on who is benefiting from growth would allow policymakers to better evaluate the long-term impact of the recent tax cuts as well as other policies?

Gross Domestic Product (GDP) is an economic measure of the value of the goods and services produced in an economy. As such, it is fundamentally designed to measure the size of a country or region's economy, but can produce misleading inferences about the well-being of American households.

GDP is especially poorly designed to measure the impacts of a tax change for a few reasons. One, changes in GDP mask changes in income and resources for households. As evidenced by analysis produced by the Congressional Budget Office, the Tax Cuts and Jobs Act boosted GDP by roughly 0.5 percent after a decade, but led to tax increases for millions of households in the outyears of the tax cut. Extrapolating the value of the tax cut based on GDP alone would suggest that all households would be somewhat better off, while many households would instead face a tax increase—especially following the expiration of the individual provisions in 2025.

More broadly, better and timelier data is critical to better evaluation of government policies and programs. This issue has gained increased attention with the 2017 report of the Commission on Evidence-Based Policymaking and subsequent bipartisan legislation to implement several recommendations contained in the report. Increased government resources for more and better data will help policymakers better understand the true economic impact of various reforms, which will ultimately lead to improved lives for American families.

RESPONSE FROM DR. HARRIS TO QUESTIONS FOR THE RECORD SUBMITTED BY REPRESENTATIVE MALONEY

I'd like to consider the topic of inequality and our shrinking middle class. According to a study by the Economic Policy Institute, between 1978 and 2017, inflation-adjusted CEO pay rose more than 1,000 percent. The median American worker's income grew only 11 percent. Most of the gains made by those workers occurred between 1978 and 2000.

Since 2000, the wages of the median worker have flatlined. For many Americans, the situation is even worse. A report by the Hamilton Project of the Brookings Institution finds that wages for the bottom 20 percent of earners fell between 1979 and 2016.

Nevertheless, the new tax law seems to exacerbate those trends. A report by Center on Budget and Policy Priorities estimates that when the new tax law is fully phased-in, the average tax cut for the top 1 percent will be more than $61,000 per year. Those with incomes in the bottom 60 percent will receive on average about $400. Households in the top 1 percent will receive an after-tax gain that is three times that of the bottom 60 percent of households.

Could you please explain the various mechanisms by which the tax law could deepen inequality? Please touch on the likely effect of the increased debt burden and of proposed cuts to Social Security and Medicare.

Analysis from a host of independent organizations has confirmed that the Tax Cuts and Jobs Act (TCJA) will deepen inequality. However, for a host of reasons, this analysis has generally understated the severity of the impact.

At first glance, the TCJA is worth substantially more to upper-income families than to those in the bottom part of the income distribution. This is undoubtedly true when examining the absolute size of the tax cut, but also true when looking at the impact relative to family income. For example, the Urban-Brookings Tax Policy Center (TPC) found that in 2018 the bill would raise income for the bottom quintile by just 0.3 percent, but by 2.2 percent for the top quintile.

These calculations, while helpful, understate the true impact on equality for a few reasons. One, they do not identify which households will be asked to repay the tax cut. Subsequent analysis by TPC found that if households are asked to repay the tax cut in proportion to their income, 90 percent of households in the bottom quintile would get a tax increase with nearly 80 percent of households in the bottom quintile seeing a drop in their income of over 1 percent. In contrast, roughly 60 percent of households in the top 1 percent would receive a tax cut. Similarly, if seniors are effectively asked to pay for the tax cut through substantial cuts in Social Security and Medicare, the decline in progressivity would be targeted towards low- and middle-income households who depend on these programs. While it is impossible to precisely measure the impact in the absence of a specific budget change, it is true that even small changes in these programs will have severe impacts on many seniors as millions depend almost exclusively on these programs for their income and benefits.

A second reason these understate the severity of the inequity is that analysis of the tax cuts often focuses on the near-term. As you know, the permanent aspect of the tax cut can be summarized as a dramatically lower corporate tax rate in return for lower rates of indexing the tax code. The decline in the corporate rate is highly concentrated among owners of capital, who tend to be those at the highest end of the income distribution, while taxpayers of all stripes are impacted by the change to inflation—including those who do not pay income tax. Thus, the magnitude of the tax cut's impact on inequality is exacerbated over time.

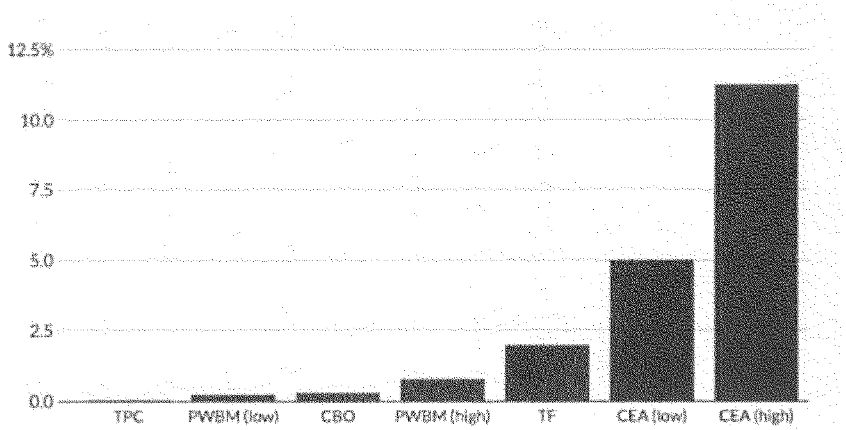
The major selling point of the tax cuts was that they would create jobs and increase wages. So far, we have seen little evidence of wage growth, particularly real wage growth.

There are wildly different estimates of the future effects of the tax cuts on wages. The graph below by the Washington Center for Equitable Growth helps put this in perspective.

Could you comment on the wide disparity between these estimates? What would happen if the most optimistic estimates are wrong? How would this affect the gap between the very wealthy and the rest of American families?

Estimates of the wage impact of the Tax Cuts and Jobs Act vary widely

Percent increase in pretax wage rates (including benefits) above baseline, 2027



Source: Tax Policy Center, Penn Wharton Budget Model, Congressional Budget Office, Tax Foundation, and Council of Economic Advisers.

Note: CBO estimate is potential labor productivity. CEA estimates based on $4,000 and $9,000 wage gains and assume no change in benefits. TF estimate constructed by the author based on published reports and auxiliary assumptions.

As the chart above shows, entities that are described as "non-partisan" and "independent" typically have more similar estimates of the economic impact of the tax cut, including in particular the impact on wages. Much of the discrepancy comes from the assumption about how a corporate tax cut—by far the most costly and consequential aspect of the TCJA—eventually filters through to wage-earners. There is actually a relatively solid consensus on this point, with CBO, JCT, Treasury's OTA, and TPC making the assumption that roughly 20 to 25 percent of a corporate tax cut will raise wages through higher productivity. It should be noted, too, that this assumption is largely based on several theoretical studies of the corporate tax incidence—economists have limited "real world" estimates of how a corporate tax cut impacts wages. Moreover, there is even less evidence on how a corporate tax impacts wages differently across the distribution of wage levels.

Under a situation where the consensus is confirmed—that is, the outlier estimates produced by the Tax Foundation and CEA are wrong—the TJCA would likely exacerbate income inequality. The magnitude of this impact would depend critically on the eventual response by Congress, and whether deficits were eventually closed through tax cuts or reduced funding for programs, but it is difficult to imagine a scenario under which wage growth remained stagnant and the tax cuts decreased inequality.

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