Embracing the Millennial American Dream

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Introduction

Chairman Coats, Vice-Chairman Brady, Ranking Member Maloney, and other Members of Joint Economic Committee, thank you for the opportunity to give testimony on how to embrace millennials' vision of the American Dream. I am a fellow at Economics21 at the Manhattan Institute for Policy Research and am the coauthor, with Diana Furchtgott-Roth, of *Disinherited: How Washington Is Betraying America's Young*.[1] Over the past four months, I have traveled across the country, to California, Illinois, Michigan, Nevada, New York, North Carolina, Oregon, South Carolina, Texas, Viginia, Wisconsin, and Wyoming, talking about my book and hearing millennials discuss their economic problems and plans for the future.

The American economy is changing, and millennials' attitudes about work and their careers are changing with it. The rapid rise of the so-called "sharing economy" embodies many young Americas' new economic ideal—one driven by technology, convenience, and flexibility. However, government policy, particularly in regards to regulation, is stuck in the 20th century and continues to hold back economic opportunity.

Millennials' Yet-Unrealized Entrepreneurial Dreams

Millennials have been called the most entrepreneurial generation. While this may be true based on their desires to start businesses and their near-universal respect for entrepreneurs such as Steve Jobs, few young Americans have followed through on their entrepreneurial dreams. Millennials' failure to start businesses follows the troubling overall trend of declining entrepreneurship and dynamism in the U.S. economy.

A Bentley University survey of millennials found that 66 percent of respondents have a desire to start their own business, 37 percent would like to work for themselves, and 25 percent would like to own their own company.[2] Echoing these findings, Deloitte found that about 70 percent of millennials envision working independently at some point in their careers.[3]

[1] Diana Furchtgott-Roth and Jared Meyer, *Disinherited: How Washington Is Betraying America's Young*, Encounter Books, May 12, 2015.
[2] "The Millennial Mind Goes to Work," Bentley University, November 11, 2014.
[3] "The Deloitte Millennial Survey," Deloitte, January 2014.

Yet, as of 2013, only 3.6 percent of private businesses were at least partially owned by someone under the age of 30. This is the lowest proportion since the Federal Reserve began collecting data nearly a quarter century ago.[4]

The Brookings Institution reports that business startup rates are much lower now than in the 1980s.[5] Business dynamism, determined by firm entry, firm exit, and job reallocation rates, has declined by over 4 percent. The fall in entrepreneurship is leading to the aging of American businesses. In 1992, 23 percent of firms had existed for 16 years or more. By 2011, this percentage had increased to 34 percent.[6]

While the Kauffman Foundation found that startups have had a small resurgence in 2015, there remains cause for concern, as the rate is well-below historic norms.[7] New business formation, including new business failure, is vital for economic growth. Entrepreneurs who start businesses greatly contribute to net job creation, something that young people who are facing an unemployment rate of 9.1 percent sorely need.[8]

Startups are also important for increasing productivity. An Organisation for Economic Co-operation and Development report shows that the slowing of productivity growth among high-income nations is not caused by sluggish innovation from cutting-edge firms.[9] Rather, the problem is that other, older firms are not keeping up. Startups are often the most productive because "young firms possess a comparative advantage in commercializing radical innovations." Productivity rises with the creation of new high-productivity firms and the exit of low-productivity competitors.

Innovation is more difficult within an existing corporation than at a startup because corporations are more focused on executing existing products than developing new ones. As author Steve Blank argues, "A company is a permanent organization designed to execute a repeatable and scalable business model."[10]

For the most part, corporate innovation cannot replace startups because corporations and startups have different goals. Established companies tend to stick to business

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[4] Ruth Simon and Caelainn Barr, "Endangered Species: Young U.S. Entrepreneurs," *The Wall Street Journal*, January 2, 2015.
[5] Ian Hathaway and Robert E. Litan, "Declining Business Dynamism in the United States: A Look at States and Metros," Brookings Institution, May 2014.
[6] Ian Hathaway and Robert E. Litan, "The Other Aging of America: The Increasing Dominance of Older Firms," Brookings Institution, July 31, 2014.
[7] Robert W. Fairlie et al., "The Kauffman Index of Startup Activity," Kauffman Foundation, 2015.
[8] "Employment Situation," Bureau of Labor Statistics, October 2, 2015.
[9] "The Future of Productivity," Organisation for Economic Co-operation and Development, 2015.
[10] Steve Blank, "Why Companies are Not Startups," March 4, 2014.

models that have proven successful. Startups, by definition, are initiating new business models that their founders believe to be original or superior to those of existing companies. Recall the new business models pioneered by millennials such as Mark Zuckerberg's Facebook, Brian Chesky's Airbnb, or Drew Houston's Dropbox.

When there are fewer entrepreneurs and new market entrants, innovation lags and existing companies face lower pressure to improve quality or lower prices. This is because new businesses are the main drivers of disruptive innovation. This is, as economist John Dearie puts it, "the sort of radical, rock-the-establishment innovation that re-makes the economic landscape, propels productivity and economic growth, and creates opportunity, wealth, and jobs for millions."[11]

A decline in entrepreneurship is troubling for the economy for a variety reasons—especially when starting a business is seen as a major part of the American dream for many millennials. Startups and the competition from new business models that they introduce are crucial for increased productivity and robust economic growth.

Regulations Stand in the Way of Millennial Entrepreneurs

A major factor that hinders entrepreneurs' ability to start new businesses is government regulation. The negative effects of laws and regulations that hold back economic opportunity are seen throughout the entire process of building a small business.

The U.S. Code of Federal Regulations is over 175,000 pages long and, without forced restraint, federal agencies will add to this total by bringing new business models under their purview.[12] The number of pages of regulation has steadily accumulated since the 1970s, but five of the six all-time-high page counts have occurred during President Obama's tenure.[13] These thousands of pages of regulation are not simply legalese. Instead, there are over one million commandments from Washington in the form of restrictive words such as "must," "cannot," or "shall."[14] Most of these restrictions have little to no connection to protecting public safety. Starting and running a business

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[11] John Dearie and Courtney Geduldig, "Entrepreneurship and the Soul of the American Economy," *Economics21*, November 14, 2013.
[12] "Code of Federal Regulations Page Breakdown—1975 through 2014," Office of the Federal Register, 2015.
[13] Clyde Wayne Crews Jr., "Ten Thousand Commandments: 2015 Edition," Competitive Enterprise Institute, May 8, 2015.
[14] "Regdata: Historical Regulation Data," Mercatus Center at George Mason University, June 2015.

requires a lot of time and hard work. Attempting to comprehend which of these million restrictions apply to their businesses is a waste of young entrepreneurs' valuable time.

It is no coincidence that the Internet technology field offers the most opportunities for young Americans, and that it is also the least regulated. If the innovative entrepreneurs behind some of today's most popular Internet companies needed to gain government's permission to innovate, or comply with as many regulations as the energy and manufacturing sectors, we would likely not have Twitter, Snapchat, Facebook, or even Apple. These are pioneering companies that young Americans use on a daily basis for everything from entertainment to news. Their skills are in such high demand in this field that they can command six-figure salaries.

Costs to Starting a Business

Financial regulations prevent entrepreneurs from securing sufficient capital to start businesses. Although about 67 percent of entrepreneurs use funds from their own savings to get their projects off the ground, it is difficult to build a company with personal savings alone.[15] When it comes to outside funding, the most common form is based on debt, as 52 percent of all entrepreneurs take out bank loans.

Equity-based funding, though more difficult to secure, is often more attractive than debt and can be very beneficial for young startups. Firms funded by angel investors or venture capitalists gain from the guidance and networks of their investors. However, the Securities and Exchange Commission implements strict regulations on equity-based investment.[16]

Small businesses, including startups, can gain exemptions from SEC's rules. Rules 504, 505, and 506 of Regulation D of the Securities Act of 1933 exempt certain companies, but, despite these exemptions, the restrictions on equity-based investment can severely limit a startup's ability to raise sufficient capital. This is a major reason why less than one percent of startups are funded by venture capitalists.[17]

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[15] "How Entrepreneurs Access Capital and Get Funded," Kauffman Foundation, *Entrepreneurship Policy Digest*, June 2, 2015.

[16] "Small Business and the SEC," U.S. Securities and Exchange Commission, October 10, 2013.

[17] Alicia M. Robb and David T. Robinson, "The Capital Structure Decisions of New Firms," *The Review of Financial Studies* (27:1), January, 2014.

The JOBS Act of 2012,[18] a law President Obama touted as one way he has aided millennials, included a provision to allow for equity-based crowdfunding.[19] Debt-based crowdfunding (such as Prosper or Lending Club) and reward-based crowdfunding (such as Kickstarter or GoFundMe) were already permitted under existing law. But the SEC has still not finalized the rules concerning equity crowdfunding. Would-be entrepreneurs who want to use this method are forced to operate within a legal gray area or delay their projects.

Barriers to Finding Work

Even if entrepreneurs are able to fund their businesses, labor regulations can prevent projects from getting off the ground. One example of this is occupational licensing, which requires people to spend substantial amounts of time and money to gain government permission to work. While it may be in the interest of public safety for states to license doctors and EMTs, it does not make any sense for low-risk occupations—such as African hair braiders, interior designers, tree trimmers, and tour guides.

Individuals who wish to enter these fields are forced to overcome major time and financial burdens to earn a living. It takes an average of 70 times as long to become a government-approved interior designer as it does to become a licensed EMT.[20] Additionally, the pass rate for the Louisiana florist exam is about half as high as the pass rate for the Louisiana Bar Examination.[21] These burdens vary across states, and licenses are rarely transferrable if a practitioner moves. This disproportionately affects those who have to move due to a spouse's job, such as military spouses, and mobile, often young, workers.

Occupational licensing restrictions discourage young entrepreneurs from pursing their dreams. Instead of starting their own companies, they may choose to work in professions that do not require licensing. University of Minnesota professor Morris Kleiner and Princeton University professor Alan Krueger have estimated that one out of

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[18] "Jumpstart Our Small Business Startups (JOBS) Act," U.S. Securities and Exchange Commission, March 26, 2015.
[19] "President Obama To Sign Jumpstart Our Business Startups (JOBS) Act," White House Office of the Press Secretary, April 5, 2012.
[20] Dick M. Carpenter et al., "License to Work: A National Study of Burdens from Occupational Licensing," Institute for Justice, May 2012.
[21] Clark Neily, *Terms of Engagement: How Our Courts Should Enforce the Constitution's Promise of Limited Government*, Encounter Books, October 8, 2013.

three American workers in 2008 had to be licensed or certified by the government to earn a living, up from one out of twenty in the 1950s.[22]

The negative effects on young people from excessive occupational licensing are one reason why President Obama released a report laying out frameworks for reform for state policymakers.[23] His 2015 budget called for $15 million to go to states that institute commonsense reforms to make sure that licensing keeps the public—not established practitioners and companies—safe.[24] While this is not much money, further initiatives to curb states' desires to license young people out of work deserve support from federal policymakers.

Because of the promising rise of popular sharing economy services such as Uber and Airbnb, and the subsequent hostile response of some legislatures, only 18 percent of millennials believe regulators primarily have the public's interest in mind.[25] Young people realize that many regulations serve to protect special interests, not public safety. These so-called "Ubertarians" want companies to be held liable for harming consumers, but they do not support regulations that keep out new competition or dictate how entrepreneurs must meet their customers' needs.

Moving forward with regulatory reform, policymakers should focus on how to open up entry for new competitors so that the rest of the economy can share in the exciting innovation seen in Silicon Valley.

Limits on Hiring

Other labor regulations affect the flexibility of entrepreneurs' hiring decisions. A recent Labor Department proposed rule would expand the numbers of employees who qualify for overtime pay (when workers put in over 40 hours per week).[26] Those who earn up to $50,400 a year might have to be paid overtime, up from a current level of $23,660 a year. According to the Labor Department, this rule would add 5 million employees to those who now have to be paid overtime, reducing flexibility for entrepreneurs and

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[22] Morris M. Kleiner and Alan B. Krueger, "Analyzing the Extent and Influence of Occupational Licensing on the Labor Market." *Journal of Labor Economics* 31: 2, 2013.
[23] "Occupational Licensing: A Framework for Policymakers," Department of the Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor, July 2015.
[24] "The Presdient's Budget Fiscal Year 2016: Middle Class Economics: Advancing Economic Opportunity and Mobility," Office of Management and Budget, February 2015.
[25] Emily Ekins, "Millennials: The Politically Unclaimed Generation," Reason-Rupe, July 10, 2014.
[26] Barack Obama, "A Hard Day's Work Deserves a Fair Day's Pay," *Huffington Post*, June 29, 2015.

employees. Telecommuting, another mainstay of startups, would also take a hit, since employers would have to keep close track of employees' hours.

Furthermore, the U.S. Department of Labor is making it more difficult for startups to hire contractors. DOL recently issued an administrator's interpretation, effective immediately, to clarify the definition of an independent contractor. DOL states that "most workers are employees," not contractors.[27]

The new interpretation, which does not have to go before the public for comments, formally accepts the so-called "economic realities" six-part test for determining whether workers are employees or contractors.[28] Problems for startups arise because the interpretation downplays the employer's lack of control over workers' hours as a determining factor. This means that more workers will be determined to be employees rather than contractors, and startups will be forced to provide the associated benefits.

The distinction between contractors and full-time employees can have important implications for startups. While labor regulations for contractors are fairly minimal, under the Fair Labor Standards Act, employees must be paid the federal minimum wage, overtime, and benefits. The Labor Department Employment Cost Index shows that providing benefits adds around 30 percent to the cost of employing a worker.[29]

When MyClean (the Uber of housecleaning) moved from independent contractors to full-time employees, its labor costs increased 40 percent, according to its CEO.[30] A similar company, Homejoy, shut down this year due to labor classification disputes.[31] Something similar could happen to Uber in California, where one driver who brought a case against the company was legally classified as an Uber employee.[32] If this ruling is extended to all of Uber's driver-partners and the rest of the emerging sharing economy, many other startups will suffer.

The problems with taking away flexibility extend to employees. When 600 Uber driver-partners were asked the question, "If both were available to you, at this point in your life, would you rather have a steady 9-to-5 job with some benefits and a set salary or a

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[27] David Weil, "Administrator's Interpretation No. 2015-1," Department of Labor, July 15, 2015.
[28] "Fact Sheet 13: Am I an Employee?: Employment Relationship Under the Fair Labor Standards Act (FLSA)," Department of Labor, May 2014.
[29] "Employment Cost Index," Bureau of Labor Statistics, October 2015.
[30] Kate Rogers, "What the Uber, Lyft lawsuits mean for the US Economy," *CNBC*, March 16, 2015.
[31] "Homejoy says goodbye, and thank you," Homejoy, July 17, 2015.
[32] *Uber Techonogies, Inc. vs. Barbara Berwick*, California Labor Commission, June 16, 2015.

job where you choose your own schedule and be your own boss?," 73 percent say that they prefer flexibility over the traditional employment model.[33]

The American Dream may have once been finding employment at a large company, working there for a few decades, and then retiring with a defined-benefit pension, but now millennials' American Dream looks much different than their parents' and grandparents'. New opportunities to change or advance one's career are prioritized, and individualized, flexible work arrangements are the model of the future.

Costs to Expanding

Starting January 1, 2016, the Affordable Care Act's employer mandate will also force companies with more than 49 full-time-equivalent employees to offer health insurance to their employees or face a $2,000 penalty per worker (the first 30 full-time workers are exempt from the penalty). Since the fine is not tax deductible, University of Chicago economist Casey Mulligan estimates that the cost to the company is actually $3,000.[34]

The law was supposed to take effect in 2014, but the Obama administration postponed the mandate's enforcement until 2015, then reconsidered once again and pushed the start date for small businesses with fewer than 100 workers to 2016. The employer mandate may be the most controversial aspect of the ACA. The administration's ongoing scramble to delay and adjust the law is an implicit admission that the mandate will damage small business expansion.

The benefits to employees and the uninsured from the employer mandate are negligible. In an Urban Institute report titled "Why Not Just Eliminate the Employer Mandate?," it was estimated that if the mandate were removed, the number of workers receiving employer-based health coverage would fall by just 0.3 percent.[35]

The Affordable Care Act had the admirable goal of making it easier for health coverage to follow workers when they change jobs. However, many aspects of the law, such as the employer mandate, do little to make health coverage portable or affordable. Until it is possible to fully reform the American healthcare system in a way that treats

[33] Jonathan V. Hall and Alan B. Krueger, "An Analysis of the Labor Market for Uber's Driver-Partners in the United States," Uber, January 22, 2015.
[34] Casey B. Mulligan, "The Affordable Care Act and the New Economics of Part-Time Work," Mercatus Center, October 7, 2014.
[35] Linda J. Blumber, John Holahan, and Matthew Buettgens, "Why Not Just Eliminate the Employer Mandate?" Urban Institute, May 9, 2014.

individual and employer health insurance the same, policymakers need to focus on eliminating—not simply delaying—the employer mandate.

Closing

Millennials want to be entrepreneurs, but government regulations hinder their ability to start their own businesses, work for themselves, and realize their entrepreneurial dreams. In order for business dynamism and the economy to improve, anti-competitive restrictions on new business formation and growth must be updated to reflect 21st century economic realities.