

The State of the American Workforce

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Chairman Kline, Ranking Member Miller, and members of the Committee I am pleased to have the opportunity to appear today to discuss the state of the American workforce. In my testimony, I wish to make a few simple points:

- The distress of the American workforce is palpable;
- Improved pro-growth policies – not more “stimulus” – are the key to a successful policy response;
- There exist currently important policy impediments to growth and job-creation; and
- Over the longer term education reform will be central to the success of the American workforce.

Let me discuss each in turn.

The Employment Picture in the United States

According to National Bureau of Economic Research the recession began in December 2007. Their data show that there were 142.002 million jobs in December of 2007 – the average of payroll and household survey data. In June 2009, NBER's date for the end of the recession, the same method showed 135.257 million jobs, for a total job loss of 6.745 million attributed to the recession. These numbers are quite close to those using the Bureau of Labor Statistics non-farm payroll, which showed a loss of 6.803 million.

There are glimmers of promise. Since December 2009, 1.1 million jobs have been added, bringing the U.S. to 130.712 million jobs. However at the same time, there are 14.5 million unemployed persons in the economy and many more discouraged workers. The peak in the size of the labor force was 155 million in October 2008, and is now estimated at slightly below 154 million.

* The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I am grateful to Cameron Smith, Michael Ramlet, Sam Batkins, Annie Hsaio, and Matt Thoman for assistance.

For these reasons, the current unemployment rate of 9.4 percent likely understates the duress. Using the BLS alternative unemployment rate (U-6), one finds that unemployed, underutilized and discouraged workers are 16.7 percent of the total. As evidence of the difficulties, the number of long-term unemployed (27 weeks or more) is currently 6.4 million and accounts for 44.3 percent of all unemployed persons.

The Need for Economic Growth

These data reflect the fact that the U.S. has suffered a deep recession and is growing slowly. Over the course of the past several years, Administrations and Congresses have engaged in a number of counter-cyclical fiscal measures (“stimulus”): checks to households (the Economic Stimulus Act of 2008), the gargantuan stimulus bill in 2009 (American Recovery and Reinvestment Act), “cash for clunkers” (the Car Allowance Rebate System), and tax credits for homebuyers (the Federal Housing Tax Credit). As this Committee is well aware there is an ongoing debate regarding the effectiveness of these measures in mitigating the natural course of the business cycle downturn.

Regardless of the ultimate resolution of that debate, I believe it would be a mistake for policymakers to evaluate future policy from that perspective. The U.S. economy *is* growing, albeit slowly, not declining. Gross Domestic Product (GDP) has been rising since the third quarter of 2009, and employment is up from its trough in December 2009. There is substantial and widespread evidence of an ongoing economic expansion. Accordingly, this is not the time for counter-cyclical “stimulus”.

The pace of expansion remains solid and unspectacular. In many ways this is not surprising. As documented in Rogoff and Reinhart (2009), economic expansions in the aftermath of severe financial crises tend to be more modest and drawn out than recovery from a conventional recession.¹ Nevertheless, at this juncture it is imperative that policy be focused on generating the maximum possible pace of economic growth. More rapid growth is essential to the labor market futures of the millions of Americans without work. More rapid growth will be essential to minimizing the difficulty of slowing the explosion of federal debt to a sustainable pace. More rapid growth will generate the resources needed to meet our obligation to provide a standard of living to the next generation that exceeds the one this generation inherited.

Drivers of Economic Growth

Policies focused on more rapid economic growth are the most important priority at this time. In light of this, it is useful to reflect on the four basic sources of growth in

¹ See *This Time Is Different: Eight Centuries of Financial Folly*, by Carmen M. Reinhart and Kenneth Rogoff, 2009.

final demand for GDP: households, businesses, governments, and international partners.

Households are caught in a double bind of badly damaged balances sheets and weak income growth. As is well known, the collapse of the U.S. housing bubble left many households in mortgage distress, and more broadly diminished the net worth of the household sector. In addition, the financial crisis itself destroyed additional household wealth, with the result that household net worth is now \$9 trillion below 2007. The pace of the expansion thus far has yielded modest income growth.

It would be surprising, or even unwise, to expect households to be a robust source of final demand growth. Instead, the best course for households would be to repair their damaged balance sheets as quickly as possible. Policies that support the ability of households to do so while otherwise maintaining their consumption patterns will be the most beneficial. There is little that one-time “stimulus” in the form of tax cuts or transfers contribute to these goals.

Similarly, federal and sub-federal governments face enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. Consider the federal budget. Over the next ten years, according to the Congressional Budget Office’s (CBO’s) analysis of the President’s Budgetary Proposals for Fiscal Year 2011, the deficit will never fall below \$700 billion dollars. Ten years from now, in 2020, the deficit will be 5.6 percent of GDP, roughly \$1.3 trillion, of which over \$900 billion will be devoted to servicing debt on previous borrowing.

The budget outlook is not the result of a shortfall of revenues. The CBO projects that over the next decade the economy will fully recover and revenues in 2020 will be 19.6 percent of GDP – over \$300 billion more than the historic norm of 18 percent. Instead, the problem is spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP – about \$1.2 trillion higher than the 20 percent that has been business as usual in the postwar era.

As a result of the spending binge, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory. Traditionally, a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis. Indeed, there are warning signs even before the debt rises to those levels.

As outlined in a recent report, the credit rating agency Moody’s looks at the fraction of federal revenues dedicated to paying interest as a key metric for retaining a triple-A rating. Specifically, the large, creditworthy sovereign borrowers are expected to devote less than 10 percent of their revenues to paying interest. Moody’s grants the U.S. extra wiggle room based on its judgment that the U.S. has a strong ability to repair its condition after a bad shock. The upshot: no downgrade until interest equals 14 percent of revenues. This is small comfort as the CBO

analysis shows 2015 as the year when the federal government crosses the threshold and reaches 14.8 percent, and continues to rise to 20.1 percent in 2020.

The federal government needs to reduce spending growth, control its debt, and do so dramatically. No sensible growth strategy can be built around greater federal spending, or greater government spending more generally.

With households and governments repairing balance sheets, this leaves the business sector spending and net exports at the heart of badly-needed pro-growth policies. Policies toward international trade are important and should be explored vigorously. The United States has been on the sidelines of international trade agreements for far too long. Pro-trade policies should be a bipartisan approach to raising growth and increasing jobs.

Current Impediments to Growth

The Fiscal Outlook

The fiscal future outlined above represents a direct impediment to job creation and growth. The United States is courting downgrade as a sovereign borrower. In a world characterized by financial market volatility stemming from Ireland, Greece, Portugal, and other locations this raises the possibility that the United States could find itself facing a financial crisis. Any sharp rise in interest rates would have dramatically negative economic impacts; even worse an actual liquidity panic would replicate (or worse) the experience of the fall of 2008.

An alternative scenario would be to appease creditors by raising additional revenue. Ultimately, this approach is likely to fail as the potential spending plans exceed any reasonable ability for the U.S. to finance via higher taxes.

In short, the failure to control future spending raises the prospect of higher interest rates or higher taxes, or both. This constitutes a serious impediment to confidence in the outlook in the United States.

The Commitment to Higher taxes

A related policy is the Administration's continued commitment to raising taxes. While the lame duck session of Congress reached an agreement to keep taxes at current levels, the Administration continues to argue that higher taxes are desirable beginning in 2013. The uncertainty over the future of the tax code is a strong policy negative, the promise to raise taxes in the future weighs adversely on employers, and the failure to commit to a sustained low tax environment remains an impediment to stronger growth.

Health Care Reform

Key provisions of the Patient Protection and Affordable Care Act (PPACA) are inconsistent with strong, pro-growth policies. In what follows, I focus on three in particular: mandate costs, administrative burdens, and tax increases.

Employer Mandate Costs

Among the key aspects of the PPACA is its mandate to cover employees with health insurance. Focusing first on those employers with more than 50 workers, beginning in 2014, those firms must pay a penalty if any of their full-time workers receive subsidies for coverage through the exchange. The penalty is equal to the lesser of \$3,000 for each full-time worker receiving a premium credit, or \$2,000 for each full-time worker, excluding the first 30 full-time workers. The fees are paid monthly in the amount of 1/12th of the specified fee amounts. Firms with fewer than 50 employees are exempt from the so-called employer “play or pay” penalties if they do not offer coverage and their workers receive a subsidy in the exchange.

From the perspective of economic performance, the most important point is that the *best* possible impact is that the firm is already offering insurance, no individual ends up receiving subsidies and triggering penalties, and thus costs are unaffected. In every other instance, health insurance will compete with hiring and growth for the scarce resources of those firms.

One might think that the same situation prevails for the smallest firms – those under 50 employees – who are exempt from the coverage mandate. Unfortunately, for these firms, the greatest impact is the tremendous impediment to expansion. Suppose for example that a firm does not provide health benefits. Hiring one more worker to raise employment to 51 will trigger a penalty of \$2,000 per worker multiplied by *the entire workforce*, after subtracting the first 30 workers. In this case the fine would be \$42,000 (21 (51-30) workers times \$2,000). How many firms will choose not to expand?

Proponents of the PPACA like to point toward the fact that small businesses will receive aid in the form of a small businesses tax credit, ostensibly offsetting the burdens outlined above. Unfortunately, the credit is available only for employers with fewer than 25 workers and those in which average wages are under \$50,000. Thus, the cost and growth impacts for those with 26 to 50 employees remains unchanged. Moreover, the credit is not a permanent part of the small business landscape. An employer may receive the credit only until 2013 and then for two consecutive tax years thereafter. Thus, the credit is available for a maximum of six years.

Turning to the credit itself, to be eligible the employer must pay at least 50 percent of the premium. The credit is equal to 35 percent of employer contributions for qualified coverage beginning in 2010, increasing to 50 percent of the premium in 2014 and thereafter. The amount of the credit is phased-out for firms with average annual earnings per worker between \$25,000 and \$50,000. The amount of the credit is also phased-out for employers with between 10 and 25 employees.

The combination of requirements for premium contributions, limitations on employees, limitations on earnings, and phase-outs has surprised the small business community. In particular, the reform's strict definition that a firm is only a small business if it has 25 or fewer employees proved convenient to the legislators who crafted the bill. This narrow definition has led to a number of studies that assert that more than 80 percent of small businesses will be eligible for the tax credit.

Even those studies that recognize the limitation imposed by the 25-employee limit tend to overstate the likely penetration of the credit. For example, the Small Business Majority and Families USA recently estimated that 84 percent of the nation's 4.8 million businesses that employ 25 or fewer employees will be eligible for the tax credit.² Unfortunately, the net impact of the credit in offsetting the cost burden of the PPACA will depend not upon *eligibility* but rather on *receipt* of the tax credits. This distinction was noted early in the debate by the Congressional Budget Office. In November 2009 when the law was being considered before Congress, CBO found that, "A relatively small share (about 12 percent) of people with coverage in the small group market would benefit from that credit in 2016."³

A more useful study focuses on the estimated number of small firms who would qualify for the small business health insurance tax credit. A recent analysis conducted by the National Federation of Independent Business (NFIB) found that the total number of firms that offer health insurance and pay more than half of their employees' premium costs, as mandated under PPACA, is more likely 35 percent of all firms with less than 25 employees.⁴

In the same way that the mandate provides an implicit tax on growth, the structure of the small business tax credit will raise the effective marginal tax rate on small business expansion. For this reason, the credit may discourage firms from hiring more workers or higher-paid workers. Consider two examples.

In the first, employers will have an incentive to avoid increases in the average rate of pay in their firm. Suppose that the average wage in a small (3 worker) firm is \$25,000 and the owner decides to add a more highly paid supervisor being paid \$50,000. This will raise the average wages in the firm to \$31,250 there by *reducing* the tax credit per worker from \$2,100 to \$1,596.⁵ In effect, the structure of the credit raises the effective cost of adding valuable supervisory capacity.

² See, http://www.smallbusinessmajority.org/pdf/tax_credit/Helping_Small_Businesses.pdf

³ See, <http://cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf>

⁴ See, <http://www.nfib.com/nfib-on-the-move/nfib-on-the-move-item?cmsid=52099>

⁵ This example assumes the employer contributes \$6,000 toward insurance for each employer.

In this example, total credits to the firm are essentially unchanged (\$6,300 to \$6,384) by raising the average wage. If the new supervisor were paid \$75,000 however, total credit payments would fall from \$6,300 to \$4,368. The lesson is clear in that the structure of the credit can impose large effective tax rates on raising the quality of the labor force for those receiving the small business credit.

Similar incentives affect the decision to hire additional workers because the overall tax credit falls by 6.7 percent for each additional employee beyond 10 workers. This is a very strong disincentive to expanding the size of the firm. Using the example above, suppose that the firm has 10 employees and total credits received were \$21,000. The firm's total subsidy will peak at \$21,840 with the hiring of the 13th worker. Thus, a firm employing 13 workers would get a total tax credit of \$21,840 while a firm employing 24 workers would receive a total credit of only \$3,360.⁶

The upshot is that the small business tax credit is a mixed economic blessing. Relatively few firms will qualify for the credit and be able to offset the costs of health insurance. For those that do qualify, receipt of the credit imposes a new regime of hidden effective marginal tax increase on improvements in scale and quality.

Administrative Costs

Perhaps the most expensive and intrusive new cost on small business is contained in Section 9006 of the PPACA. This adds a new information reporting requirement mandating that business will have to issue Forms 1099 for goods purchased after 2011, regardless of the corporate form of the vendor. Vendors of goods will have to furnish, and businesses will have to collect, Tax ID numbers for all aggregate purchases totaling over \$600 annually. If a vendor fails to furnish a correct Tax ID, the businesses receiving the goods is required by law to impose back-up withholding at the rate of 28 percent of the purchase price. This means that businesses will now have to keep records of all purchases and keep them sorted by Tax ID.

This costly expansion of administrative requirements has nothing to do with the objectives of health care reform. Thus, it is best viewed as an initiative in tax administration. From this perspective its inclusion is puzzling as neither the National Taxpayer Advocate nor the Treasury Department recommended this 1099 legislation that extends information reports to vendors of goods. The Office of the Taxpayer Advocate is concerned that the new reporting burden, particularly as it falls on small businesses, may turn out to be disproportionate as compared with any resulting improvement in tax compliance.⁷

⁶ See, <http://www.ncpa.org/pdfs/ba703.pdf>

⁷ See <http://www.irs.gov/newsroom/article/0,,id=225270,00.html>

The health care reform's 1099 provision would apply to businesses of all sizes, charities and other tax-exempt organizations and government entities. Based on tax returns filed in 2009 for tax year 2008, more than 41 million organizations will now need to submit 1099 forms. This will be an administrative nightmare for businesses and non-profit organizations.

Moreover, it is not obvious that the Internal Revenue Service will be able to make productive use of this new volume of information reports. In general, the IRS' document matching system compares amounts shown on a taxpayer's tax return with amounts shown on third-party information reports like the form W2. Under this new provision, the amounts on the 1099 information reports will not match the tax returns.

Thus, from a tax administration perspective, it is exceedingly doubtful that the Section 9006 mandate comes close to making sense from a benefit-cost perspective. However, the greatest concern is the hidden impact of the 1099 provision on the operation of small businesses. For example, small businesses seeking to minimize recordkeeping burdens now have an incentive to use large vendors that can produce Tax ID reports for them. As a result, small business that lack that capacity to track customer purchases may lose customers, leaving the economy with more large national vendors and less local competition.

Tax Increases

The Act raises more than \$700 billion in tax revenue from an excise tax on high-premium plans; reinsurance and risk adjustment collections; penalty payments by employers and uninsured individuals; fees on medical device manufacturers, pharmaceutical companies, and health insurance providers; and other revenue provisions. There is no theory or empirical research on job creation that suggests that large tax increases will spur employment. Taken at face value, one should be skeptical that PPACA will not harm the pace of overall economic recovery.

There are two taxes of particular interest contained in PPACA. Section 9015 increases the Medicare HI tax by 0.9 percentage points on wages in excess of \$200,000 (\$250,000 for couples filing jointly, \$125,000 for married individuals filing separately), and also applies to self-employed earnings.

Sec. 1402 of HCERA imposes a 3.8 percent Medicare contribution tax on individuals, estates, or trusts of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount. The threshold amount is \$250,000 for joint returns, \$125,000 for married filing separately, or \$200,000 for any other case. Both taxes are effective for taxable years beginning after 2012.

The first point to note is that these taxes have nothing to do with Medicare finance. While gross inflows may be credited to the HI trust fund, these dollars will finance the expansion of the new insurance subsidy entitlement program.

The second point to note is that these taxes apply to the labor and investment earnings of pass-thru entities taxed through the individual income tax. Thus, they are targeted at precisely the same group of individuals most likely to be business owners or entrepreneurs. The Joint Committee on Taxation projects that \$1 trillion in business income will be reported on individual income tax returns in 2011. Notably, of that \$1 trillion, roughly one-half, \$470 billion, will be reported on returns that are likely to be the new surtaxes.⁸

This has the potential to impact employment. According to the Small Business Administration, there are almost 120 million private sector workers in the United States. Slightly more than half those workers, 60 million, work for small businesses. About two-thirds of the nation's small business workers are employed by small businesses with 20 to 500 employees. According to Gallup survey data conducted for the National Federation of Independent Business (NFIB), half of the small business owners in this group fall into the surtax brackets. This means there is a pool of more than 20 million workers in those firms directly targeted by the higher marginal tax rates. This is likely a conservative estimate as it ignores flow-through entities with one to 19 workers.

A final tax impact of the PPACA is that the impact of phase-outs of refundable credits may have even more perverse growth consequences. As noted in Brill and Holtz-Eakin (2010) the phase-outs in insurance subsidies contribute to high effective marginal tax rates.⁹ The effect is to raise to as high as 41 percent the effective marginal tax rate on some of the lower-income U.S. workers. This has implications for the ability of families to rise from the ranks of the poor, or to ascend toward the upper end of the middle class. This growth and mobility is the heart of the American dream and is the most pressing issue at this time.

The Regulatory Environment

The year 2010 displayed tremendous federal regulatory activity. During a period of persistently high unemployment, federal agencies were more than prolific, proposing a record number of regulations, and at a record cost for the U.S. economy. The legislative measures passed this past year and their subsequent implementation will continue to dominate the regulatory environment. New Dodd-Frank

⁸ The Joint Committee on Taxation analysis does not take into account the impact on small, non-publicly-traded "C" corporations. There are several million of these entities, which will likely be adversely affected by the marginal rate increases on ordinary and capital income.

⁹ Brill, Alex and Holtz-Eakin, Douglas, "Another Obama Tax Hike." *Wall Street Journal*, February 4, 2010. See also, Douglas Holtz-Eakin and Cameron Smith, "Labor Markets and Health Care Reform, 2010.

http://americanactionforum.org/files/LaborMktsHCRAAF5-27-10_0.pdf

regulations, Net Neutrality, and the EPA's CO₂ framework kept federal regulators busy in 2010 and 2011 appears to be little different.

The *Federal Register* published 82,590 pages in 2010¹⁰, an historic high. This figure was an 18.5 percent increase from 2009¹¹, and up almost 11 percent since 2007¹².

The number of pages doesn't tell the whole story of the impact regulations have on businesses and consumers. For example, according to the U.S. Small Business Administration¹³, the total regulatory burden in 2008 was \$1.75 trillion, or roughly 12 percent of the nation's total economic output.

In 2010, the federal government promulgated 2,401 proposed rules, 3,562 new rules, of which 673 were considered significant. According to the Office of Information and Regulatory Affairs (OIRA), there are 136 major rulemakings (averaging at least \$100 million) under review.¹⁴ Calculating the total cost of these regulations can prove difficult even for the individual agencies, as they routinely request comment from industry experts.

When the federal government does provide and estimate, the total cost might seem small in isolation. But combined with thousands of other regulations, and the economic impact on businesses and consumers can become onerous. For example, in the last quarter of 2010, the total cost of proposed or enacted regulations (including regulations proposed by Congress) exceeded \$43.8 billion, according to Forum calculations. This figure only includes the conservative agency estimates that tabulate recordkeeping burdens and costs of compliance.

The Heritage Foundation¹⁵ has also conducted research on Fiscal Year 2010 regulations. According to their calculations, the total cost of enacted federal regulations was \$26.5 billion, the highest ever recorded. The EPA's onerous new rules on carbon regulation, among many others, accounted for the lion's share of the total, \$23.2 billion.

In addition, onerous cooling water rules regulating power plants could cost thousands of jobs in the energy sector. By next year, the EPA is likely to finalize cooling water intake regulations that could affect up to 252 gigawatts of generation

¹⁰ <http://www.gpo.gov/fdsys/pkg/FR-2010-12-30/pdf/FR-2010-12-30.pdf>

¹¹ <http://www.gpo.gov/fdsys/pkg/FR-2009-12-31/pdf/FR-2009-12-31.pdf>

¹² <http://www.gpo.gov/fdsys/pkg/FR-2007-12-31/pdf/FR-2007-12-31.pdf>

¹³ http://docs.google.com/viewer?a=v&q=cache:910Pe1MSaCgJ:www.sba.gov/ADV0/research/rs264tot.pdf+%22the+impact+of+regulatory+costs+on+small+firms%22&hl=en&gl=us&pid=bl&srcid=ADGEEsGnKjwH2t_hcPMeJXecfZ15xOnHz4Z5TJkAT8KhYWe0-Ud5ywi2tvTc_Yo8Pjz94KCQYg9nvWiK5FI6E

¹⁴ <http://www.reginfo.gov/public/>

¹⁵ <http://www.heritage.org/research/reports/2010/10/red-tape-rising-obamas-torrent-of-new-regulation>

capacity. To put this figure in perspective, the new EPA regulations could force the closure of the Mirant power plant in Alexandria, VA, which produces approximately 484 megawatts. Thus, EPA action could affect up to 500 Mirant-sized power plants.

The EPA was not alone, however. 2010 showed activity by several regulatory agencies. The Federal Communication Commission's unilateral attempt to impose so-called "net neutrality" is a key rule in 2010; legal challenges will make it almost impossible to implement fully in 2011. According to industry expert Bret Swanson, if net neutrality results in just a ten percent decline in IT infrastructure investment, it could cost the U.S. economy more than 502,000 jobs.¹⁶

Similarly, the passage of Dodd-Frank and its initial implementation will also put regulatory pressure on businesses and consumers in 2011.

Improving the Long-Run Quality of the Workforce

The Challenge

As is now well-understood, skills are central to labor market success. And for the nation as a whole, labor market success rests on an education system that aims for the highest standards and regularly delivers workers prepared for a lifetime of work characterized by skill acquisition and occupational mobility.

Unfortunately, student achievement in the United States lags behind the rest of the industrialized nations, and is falling further behind. In the United States, there are predictable gaps in achievement based on wealth and ethnicity. New solutions and innovative policies are needed to address this growing crisis. Pouring more money into the existing system alone will not be a successful solution.

The U.S. is not meeting the challenge of international competition. The Organisation for Economic Co-operation and Development (OECD) found that in 2006, America ranked 25th out of 30 industrialized countries in math and 24th in science. Moreover, cross-country comparisons of US students at two different ages – either 9-10 or at age 15 – suggest that as the young get closer to joining the labor force, the further they lag behind their international counterparts in reading, math, and science.

Within the United States, overall achievement is too low. Of 100 children born in 1983 who started kindergarten together in 1988, 30 of them would not have graduated on time in 2001. Of the 70 who would have graduated, 50 would start college, and just 25 of those 100 kindergartners would have a college degree by

¹⁶[http://www.google.com/url?sa=t&source=web&cd=3&ved=0CCAQFjAC&url=http%3A%2F%2Fwww.nyls.edu%2Fuser_files%2F1%2F3%2F4%2F30%2F83%2FDavidson%20%26%20Swanson%20-%20NN%20Economic%20Impact%20Paper%20-%20FINAL.pdf&rct=j&q=swanson 502%20000 %2](http://www.google.com/url?sa=t&source=web&cd=3&ved=0CCAQFjAC&url=http%3A%2F%2Fwww.nyls.edu%2Fuser_files%2F1%2F3%2F4%2F30%2F83%2FDavidson%20%26%20Swanson%20-%20NN%20Economic%20Impact%20Paper%20-%20FINAL.pdf&rct=j&q=swanson%20502%20000%20)

spring 2007. On average, students of color have a much lower, 50 percent, likelihood of graduating. Of those students of color who do graduate, they typically exit high school with the functional equivalent of an 8th or 9th grade education.

Furthermore, in higher education, the OECD also found in 2006 that the U.S. ranked 12th in higher education attainment among industrialized countries in the world, ranking higher than only six other nations.¹⁷ The college dropout rate, as defined by taking more than six years to graduate, is also more than 40 percent.¹⁸ Higher education needs to address issues of access, affordability, and improvement of quality and accountability.

The trends across countries and over time are not explained by spending. In 2004, U.S. spending (measured as a percent of GDP) ranked 3rd out of 34 OECD countries. U.S. spending is almost 7.5 percent of GDP. Similarly, in 1983, total spending on K-12 education in the U.S. was \$118.4 billion. If spending had increased only at the rate of inflation, spending would have been \$246 billion in 2005. Instead, the U.S. spent \$499 billion – about double the inflation-adjusted amount in 1983. The increase is not just due to more students; per-student spending grew from \$5,691 in 1983 to almost \$9,266 in 2005, after adjusting for inflation.

And what has been the result? Student performance as reported by the National Assessment of Education Progress (NAEP) on reading and math has remained essentially flat. Our educational system is getting the same output for an increasing cost – the system is 40 percent less efficient.

Principles for Better Performance

I believe we would be well served to adhere to the principles of excellence through competition and specialization. One way to think of this is to permit choice to work in many sectors at once: the traditional district sector, the district choice sector (magnets and open enrollment), the charter schools sector, and the private choice sector. Each of these sectors has a role to be played, and by embracing all of them in a co-existing model, we can greatly expand the number of effective models for students. The job is to create policies that allow for innovation without falling prey to the notion of a one-size-fits-all classroom.

In light of this, it is encouraging to see a bipartisan interest in building on the reforms of the No Child Left Behind law to improve K-12 education in the United States.

¹⁷ See, <http://www2.ed.gov/about/bdscomm/list/hiedfuture/reports/pre-pub-report.pdf>

¹⁸ http://nces.ed.gov/programs/digest/d09/tables/dt09_331.asp?referrer=list

But there are good reasons to go slowly and make sure it is done right. Accountability has three facets. First, as noted above, I think it must be built upon a foundation of increased opportunity for school choice. An example of how school choice has been effective is looking at the DC Opportunity Voucher Program which was congressionally mandated to be evaluated by the Institute of Education Sciences (IES) before the program was eventually cut. Results showed that the program raised a student's probability of completing high school by 12 percentage points, from 70 percent to 82 percent, and that there was an increase in parent satisfaction of student education.¹⁹ Every school will be more accountable if failure for students means failure for the teaching bureaucracy. Second, it includes state-level efforts, such as those in Florida that graded schools and energized parents to demand improvements in subpar performers. Finally, it includes oversight of federal programs to ensure that the taxpayers' dollars are used effectively.

Second, Members will need to take some time to find out what is happening on the ground. This is especially true given the large influx of nearly 100 new House Members and Senators who will need to get up to speed on the facts in an area where urban legend often rules.

For example, how did states and localities spend the billions of dollars in stimulus funding (nearly \$100 billion) and "EduJobs" (\$10 billion) funding, including the Obama Race to the Top initiative? Many states passed laws over the last year to improve their charter school laws and to change the way they compensate high performing teachers in order to be competitive to win one of the Race to the Top grants. The Race to the Top winners are only just now beginning to implement the reforms described in their applications. Are these reforms effective? Are they good models for others states? Given the importance of identifying and rewarding quality teaching (and – the mirror image – identifying and eliminating low-quality teaching) these are questions that must be answered before taking the next steps.

Third, as Congress takes steps to improve the Elementary and Secondary Education Act, the top priority is to make sure it keeps students, parents, teachers and communities first, as they are on the front lines and most able to improve student achievement. This requires serious outreach, not the kind of Washington-centric, ram-it-through-before-they-catch-us mentality that has prevailed the past two years.

Finally, as members of Congress scrutinize the current law and digest the new reforms taken by states and localities, it must first and foremost ensure that that reauthorization balances the federal and local roles. The voters have made clear their distaste for federal overreach. Thus, for example, mandating that states adopt Common Core (curriculum) Standards in order to receive funds is a step in the wrong direction. Instead, states should have the freedom to take this step on their own. At the same time, pretending that 100 percent local control would work is to

¹⁹ See, <http://newswire.uark.edu/Article.aspx?ID=14329>

de facto condemn the very students who need freedom from their failing schools. Getting this balance right will take time.

Conclusions

The American workforce is under serious distress as a result of the most recent recession out of which we are only slowly growing. More rapid growth – in the form of repaired balance sheets, reduced federal spending and pro-growth policies – is essential to the labor market futures of the millions of Americans still out of work. Immediate hurdles to growth and job creation include the dire fiscal outlook of the US; the higher taxes promised in 2013; the mandates, administrative burdens and tax increases promised in the health care reform; and the ever-increasing regulatory rulemakings.

Despite the impediments, there remains room to improve. Education reform – using education dollars more effectively, increasing choice and improving measures of accountability – is central to the success of the American workforce.

Members of the Committee thank you for the opportunity to be here today. I look forward to answering your questions.