

# Testimony of Lawrence Kudlow for the U.S. Congress Joint Economic Committee

## THE RECOVERY AT FIVE YEARS

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As we all know, the current economic recovery is sub-par. In fact, at roughly 2 percent average real growth over the past five years, it's the slowest rebound since World War II.

A few brief observations:

First, the massive federal stimulus of 2009-10 did not work. There were no so-called fiscal multipliers. And far too much debt was accumulated for no good reason.

Second, substantial overregulation has continuously hobbled the recovery. Tax rates have gone up across-the-board. The Dodd-Frank financial regulation has not solved Too Big to Fail, but it has contributed to an abnormally slow increase in C&I loans, particularly in the middle market. EPA overreach has created substantial uncertainties, as has the NLRB. Most of all, I believe the Affordable Care Act has thrown a wet blanket over the entire economy: Business hiring has been disappointing, even with rising profits. Part-time jobs are exploding. Full-time jobs are declining. Millions of people have dropped out of the labor force. Both the labor-force participation rate and the employment-to-population ratio remain near rock bottom. Wage gains are subnormal. And long-term business investment, which is typically a huge job-creator, has been disappointing to say the least.

The failure of business cap-ex may be the single biggest hole in the so-called economic recovery. That is why I believe slashing the corporate tax rate is the most important pro-growth measure that should be taken. I'd like to see the corporate tax completely abolished. But I'd settle for a 20 percent rate. (Incidentally, studies show that 70 percent of corporate tax relief goes to wage earners.) Additionally, investment cash expensing should be given 100 percent write-offs, all other credits and deductions should be eliminated, and corporate welfare and cronyism should be ended. And let me put a plug in for removing the Ex-Im Bank.

I do applaud the slowdown in federal spending, which has dropped from over 24 percent of GDP to below 21 percent. At least this gives the private sector more room to breathe. Large-scale budget reductions in 2011 and 2013 did not crash the economy or the moderate jobs recovery, as my Keynesian friends widely predicted.

Staying with fiscal-policy issues, leftist economists like Thomas Piketty who want 80 percent tax rates on the most successful have their data and story completely wrong. We should be flattening personal tax rates toward the 15 percent area and ridding ourselves of virtually all deductions and credits. Along with lower corporate taxes and more sensible regulations, these

supply-side reforms have the potential to grow the economy at 4 or 5 percent and make up for the \$1.5 trillion loss of potential GDP and the 6 million jobs gap. These figures are based on long-run baselines dating back to at least 1960.

The good news is the rise of the stock market, which has increased 190 percent from the depths of the 2008 meltdown. Total economic profits have increased 94 percent. And the profit-driven stock market rally (along with ultra-low interest rates) has contributed to a \$9.7 trillion increase in household net worth.

The problem is that not only have corporate profits not been invested in long-term capital projects, mainly as a result of tax and regulatory uncertainties, but firms are shifting cash overseas to avoid U.S. corporate tax penalties. You hate to see it, but low tax rates around the world attract cash, in this case almost \$2 trillion in American corporate cash. Policymakers should encourage the repatriation of this money with a modest 5 percent penalty rate.

Finally, a word about monetary policy. The massive \$3 trillion-plus buildup of the Fed's balance sheet -- somewhat akin to the explosion of federal-government spending -- did not work. Money multipliers have been collapsing along with the hand-to-hand rate of velocity. The zero Federal Reserve target rate, at five-years-plus after the financial meltdown, is too low and is contributing to a distortion of risk assessment in the financial markets. Moreover, the Fed has relapsed into the nonexistent Phillips-curve tradeoff between inflation and unemployment. Ms. Yellen's dashboard of labor-market indicators makes your head spin. That's no way to conduct policy. More people working does not cause inflation. Excess money and a devalued dollar do.

Miraculously, both actual and expected inflation indicators have stayed low. Perhaps that's because the actual money supply never exploded, as crashing velocity offset the rising monetary base. Preferably, future monetary policy will move back toward a rule-based approach, which prevailed during the prosperity of the 1980s and 1990s. I favor the Taylor rule, supplemented by market-based indicators such as gold, broad commodity indexes, the shape of the Treasury yield curve, and the dollar exchange rate. Right now, these indicators look pretty calm. So on the inflation front, I would suggest that the Fed declare victory and go home.

Regarding the disappointing labor market and sub-par economic growth in general, only pro-growth supply-side policies will fix the problems and put America back on the road to prosperity.