STATEMENT OF:

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Regarding:

"Where the Jobs Are: Employment Trends and Analysis"

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Chairwoman Bono-Mack, Ranking Member Butterfield, and members of this subcommittee, thank you for the opportunity to present testimony of behalf of my organization, the Competitive Enterprise Institute, in this hearing asking the important question of “where the jobs are.”

Another way of asking this question is, “where are new jobs most likely to be created.” In my testimony, I will focus not on particular locations or industries, but rather on characteristics of the firms for the past few decades have been most responsible for job creation. Scholars affiliated with the Ewing Marion Kauffman Foundation in Kansas City, Mo., an institution that has won widespread acclaim for the research it produces on entrepreneurship and its role in economic growth, have a convincing answer to this question, an answer that has been embraced by many in public policy including President Obama’s Council on Jobs and Competitiveness

On net, where the jobs “are” or have been created, is at firms of all sizes from zero to five years old. As noted by the Obama Jobs Council report[1], “over the last three decades, young firms less than five years old have created 40 million new jobs,” accounting for “all net new jobs” during that period. Especially important among these companies are innovative high-growth firms referred to as “gazelles” that are found to double both their revenues and employment every few years and are found in every sector and region.

Unfortunately, a series of adverse financial regulations, many of which were enacted and promulgated in the supposed “deregulatory” era of the last decade, have stunted these firms growth by making it much more difficult for them to access to capital through means such as launching an initial public offering. As the Obama Jobs Council notes, "Well-intentioned regulations aimed at protecting the public from the misrepresentations of a small number of large companies have unintentionally placed significant burdens on the large number of smaller companies."

[1] http://files.jobs-council.com/jobscouncil/files/2011/10/JobsCouncil_InterimReport_Oct11.pdf

This regulatory overhang may explain part of the slower-than expected recovery. According to the Treasury Department's IPO Task Force[2], the long-term decline in IPOs over the last decade may have cost the economy **as many as 22 million jobs not created during that period**.

The good news is that there is an emerging bipartisan consensus on scaling back regulations that burden these firms, with proposals to do so being embraced by both the House leadership and the Obama administration. Contrary to media reports, members of the House from both parties and the administration are finding common ground on some jobs bill, particularly regarding access to capital. In fact in one week this autumn, this House passed four bills with near-unanimity -- more than 400 votes for each measure -- to ease regulatory barriers to access to capital. These bills, still lingering in the U.S. Senate, would lift barriers to innovations such as "crowdfunding," in which smaller firms can utilize social networking to raise seed capital, and make it easier for entrepreneurs to connect with venture capitalists and angel investors through general advertising.[3]

Your colleagues in the House Financial Services Committee are also slated this week to mark up a bill designed to smooth the IPO process for these young firms by creating a so-called on-ramp of regulatory relief. H.R. 3606, the Reopening American Capital Markets to Emerging Growth Companies Act of 2011 sponsored by Reps Stephen Fincher (R-Tenn.) and John Carney (D-Del.), exempts firms going public from some of the most burdensome provisions of the Sarbanes-Oxley Act of 2002 and the Dodd-Frank financial overhaul of 2010, and also eases rules for firms providing analyst research of these companies. These rules would only kick in after the company has been public for five years or reaches a market cap of $1 billion, whichever comes first.

My organization, the Competitive Enterprise Institute, is a Washington-based free-market think tank that since its founding in 1984 has studied the effects of all types of regulations on job growth and economic well-being. As we have said before, we follow the regulatory state from "economy to ecology," and

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[2] http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf
[3] The bills are H.R. 1070, H.R. 1965, H.R. 2930, and H.R. 2940.

propose ideas to "regulate the regulators" and hold them accountable so that innovation and job growth can flourish in all sectors.

Our theme on job growth has been "liberate to stimulate," because as our Vice President Wayne Crews has observed, one doesn't need to teach – or subsidize -- grass to grow. Rather, remove the rocks obstructing its growth, and it will grow wide and tall. In September, we released a "Ten-Point Jobs Plan"[4] with recommendations ranging from lifting barriers to energy exploration to reforming our visa process to allow more high-skilled immigrants to contribute their talents to this country and help build more firms essential for job growth.

But of all the regulations out there facing entrepreneurs, among the most important are those affecting access to capital, which is my area of policy scholarship. All startup firms, from food service to biotechnology to so-called green energy, need capital through debt and/or equity. The debt side has gotten much attention with the credit crunch and the resulting lack of loans for small and midsize businesses. But the equity side – financing company growth by issuing shares of stock – is equally important. To put it simply, every dollar a firm can raise by an offering of stock to an investor is one less dollar the firm has to raise by begging to borrow it from a bank.

But regulatory burdens over the past decade – such as the Sarbanes-Oxley Act and restrictions on the compensation of analysts covering small firms for investment banks, along with looming burdens of Dodd-Frank, have skewed emerging growth firms away from going public and toward more debt financing of growth, as well as toward mergers and acquisition rather than initial public offerings. This has stark implications for job growth

As noted by President Obama's Jobs Council, 90 percent of job creation by public firms occurs after they go public. Yet many emerging growth firms never go public, and instead are acquired by larger firms.

[4] http://cei.org/news-releases/ceis-ten-point-plan-create-jobs

“This clearly hurts job creation,” the council noted, because “the data clearly shows that job growth accelerates when companies are going public, but often decelerates when companies are acquired.”

In the few years, the number of American firms launching initial public offerings (IPOs) of stock has sunk to its lowest level, by some measures, since the 1970s. This fact is often assumed to be just another symptom of a slow recovery following a horrendous financial crisis. But it’s important to note that this marked decline began even before the financial crisis and goes all the way back to the early part of the last decade. The number of IPOs in every year since 2001 has lagged behind not just the boom years of the late 1990s but also the early years of that decade when the U.S. was mired in a recession. The IPO Task Force notes that there were about 50 more IPOs in 1991 than there were in 2006 and 2007, relatively good years for economic growth.

Furthermore, the size of firms launching these IPOs has increased. The Jobs Council notes that in the 1990s, 80 percent of IPOs were for firms with market capitalization below $50 million. In the next decade, the inverse was true, with IPOs of this smaller size accounting for only 20 percent of the shrunken total.

The big-name IPOs of the past year are a tribute to American innovation, but they also illustrate the problem. Groupon and LinkedIn had market caps exceeding $1 billion by the time they went public. Facebook, which has yet to go public, may have a market cap as high as $100 billion before it lists its shares on a public exchange.

By contrast, when Home Depot went public in 1981, the company had only opened four stores. It and other companies of its size accessed the public markets to raise capital to grow. In contrast, IPOs are launched today mostly to provide liquidity in private firms in which growth has already taken place.

And with specific regard to Home Depot, the firm’s co-founder Bernie Marcus has said many time the company likely never could have gotten off the ground if Sarbanes-Oxley and other of today’s regulations had been in effect. “We could never succeed today,” Marcus bluntly told radio host Hugh Hewitt.

On top of this for all its cost – and the annual cost of just one section, that of the 404(b) mandate to for auditors' certification of "internal controls" comes to an average of $2.3 million per firm according to the Securities and Exchange Commission – Sarbanes-Oxley has failed in its initial goal of stopping scandals at large public companies. Countrywide, Lehman Brothers, and MF Global skated through their Sarbanes-Oxley certifications, while smaller firms were hobbled by its red tape and accounting minutiae (which has included reports of the auditing of such trivial items such as employee passwords and possession of office keys) Financial analyst Janet Tavakoli recently said, Sarbanes-Oxley did nothing. It didn't work. It was a total waste."

On the debt side of the ledger, there are also plenty of laws and regulations that block access to capital while achieving little benefit for consumers, investors, or the financial system. One example is an arbitrary lending cap on the business loans credit unions can make to their members. No5 matter the safety and soundness of the loans, credit unions can never make these in excess of 12.25 percent. In this case too, there are bipartisan efforts to clear these barriers, with the Small Business Lending Enhancement Act being sponsored by Ed Royce (R-Calif.) in the House (H.R. 1418) and Mark Udall (D-Colo.) in the Senate (S. 509).

Given the ingenuity of American entrepreneurs and the broad-mindedness of the investors who fund them, clearing away irrational regulations might very well lead to a hearing entitled "where the jobs aren't." The House is has passed some essential access-to-capital bills, and the Senate needs to be told to, in the words of the president, pass these bills now.

Thank you again for inviting me to testify, and I look forward to answering your questions.