S. HRG. 116–123

ECONOMIC MOBILITY: IS THE AMERICAN DREAM IN CRISIS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
ECONOMIC POLICY

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

EXPLORING BARRIERS TO ECONOMIC MOBILITY AND MAKING THE AMERICAN DREAM ATTAINABLE FOR ALL AMERICANS

JULY 17, 2019

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PUBLISHING OFFICE
39–541 PDF WASHINGTON : 2022

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MIKE CRAPO, Idaho, *Chairman*

RICHARD C. SHELBY, Alabama	SHERROD BROWN, Ohio
PATRICK J. TOOMEY, Pennsylvania	JACK REED, Rhode Island
TIM SCOTT, South Carolina	ROBERT MENENDEZ, New Jersey
BEN SASSE, Nebraska	JON TESTER, Montana
TOM COTTON, Arkansas	MARK R. WARNER, Virginia
MIKE ROUNDS, South Dakota	ELIZABETH WARREN, Massachusetts
DAVID PERDUE, Georgia	BRIAN SCHATZ, Hawaii
THOM TILLIS, North Carolina	CHRIS VAN HOLLEN, Maryland
JOHN KENNEDY, Louisiana	CATHERINE CORTEZ MASTO, Nevada
MARTHA MCSALLY, Arizona	DOUG JONES, Alabama
JERRY MORAN, Kansas	TINA SMITH, Minnesota
KEVIN CRAMER, North Dakota	KYRSTEN SINEMA, Arizona

GREGG RICHARD, *Staff Director*
LAURA SWANSON, *Democratic Staff Director*

CAMERON RICKER, *Chief Clerk*
SHELVIN SIMMONS, *IT Director*
CHARLES J. MOFFAT, *Hearing Clerk*
JIM CROWELL, *Editor*

SUBCOMMITTEE ON ECONOMIC POLICY

TOM COTTON, Arkansas, *Chairman*
CATHERINE CORTEZ MASTO, Nevada, *Ranking Democratic Member*

KEVIN CRAMER, North Dakota	ROBERT MENENDEZ, New Jersey
BEN SASSE, Nebraska	DOUG JONES, Alabama
DAVID PERDUE, Georgia	TINA SMITH, Minnesota
THOM TILLIS, North Carolina	KYRSTEN SINEMA, Arizona
JOHN KENNEDY, Louisiana	

KYLE HAUPTMAN, *Subcommittee Staff Director*
CAROL WAYMAN, *Democratic Subcommittee Staff Director*

C O N T E N T S

WEDNESDAY, JULY 17, 2019

WITNESSES

Additional Material Supplied for the Record

ECONOMIC MOBILITY: IS THE AMERICAN DREAM IN CRISIS?

WEDNESDAY, JULY 17, 2019

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON ECONOMIC POLICY,
Washington, DC.

The Subcommittee met at 9:38 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Tom Cotton, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF SENATOR TOM COTTON

Senator COTTON. This hearing will come to order.

Welcome to the Economic Policy Subcommittee hearing on this important topic of "Economic Mobility: Is the American Dream in Crisis?" I would like to thank Senator Cortez Masto and the witnesses for being here and also our Banking Committee staff for their help pulling this all this together. Now I want to introduce our witnesses.

Mr. Oren Cass is a Senior Fellow at the Manhattan Institute and the author of the 2018 book, "The Once and Future Worker: A Vision for the Renewal of Work in America." Mr. Cass was formerly the Domestic Policy Director of Senator Romney's Presidential campaign in 2012.

Dr. Yuval Levin is a Resident Scholar at the American Enterprise Institute and the founding Editor of National Affairs. Dr. Levin served as a Member of the White House Domestic Policy staff under President George W. Bush.

Mr. Ramesh Ponnuru is a Visiting Fellow at the American Enterprise Institute, a Senior Editor for National Review, and a columnist for Bloomberg Opinion.

Ms. Thea Mei Lee is President of the Economic Policy Institute and formerly the Chief International Economist for the AFL–CIO. She has served on advisory boards for the State Department and the National Bureau of Economic Research.

And Mr. Keith Miller is the founder of Franchisee Advocacy Consulting. A Subway franchisee himself since 1988, he served as Director on the North American Association of Subway Franchisees.

Thank you all for coming and for your testimony. Your written testimony will be entered into the record.

We are here to discuss economic mobility and the American Dream. When economists discuss these things, they often think in terms of GDP growth and consumer prices. To exaggerate just a little, they often seem to believe that so long as the economy grows at 3 percent and Americans can afford more cheap plastic stuff from China, America must doing great. But is that really true?

When I talk to Arkansans, I hear a different story. Most of them do not dream of extravagant wealth, much less abstract ideas like "economic growth" and "consumer surplus." They know a life of getting and spending cannot hope to fulfill one's dreams.

Instead they dream of a career that pays an honest wage so they can live in a decent neighborhood. They dream of getting married and starting a family. And, ultimately, they dream of passing on this standard of living to their children—plus a little bit more. That is the American Dream I hear, according to the Arkansans that I know.

The question for today is: Is our Nation helping Americans achieve this American Dream, or are we failing them?

I have to say, I think in some important ways our Nation is failing our fellow citizens. The labyrinth of subsidies, regulations, and misguided priorities constructed here in Washington often does little to help a large majority of Americans who do not graduate from college, the "Silent Majority" who work with their hands and on their feet.

Our Government does not offer these Americans much beyond occasionally moralizing about their supposed shortcomings: "go to college," "abandon your hometown," "learn to code."

What they really need are more viable career paths that do not require expensive educations. There are many good-paying, honorable jobs for people without college degrees in this country. But how do we create even more of them? How do we prepare workers so they are ready for those jobs?

There is another urgent context for today's hearing as well: our economic competition with China. For decades, Washington has pursued a policy of integration with China. The architects of this policy hoped naively that enriching the Chinese Communist Party would make it more pliable and less communist. Instead, it gave China the means to challenge America around the world—all while decimating the American heartland.

If we want to remain the world's strongest economy, we need to marshal every citizen, every skill, every talent at our disposal. We will need to recover the vitality, productive abilities, and indeed the patriotism that contributed to America's resounding triumphs in the past century.

If we build a more productive economy, it will serve not only our strategic interests as a Nation, but the interests of the American people, by helping them achieve the American Dream.

I look forward to your thoughts and to my colleagues' questions.

Senator CORTEZ MASTO.

OPENING STATEMENT OF SENATOR CATHERINE CORTEZ MASTO

Senator CORTEZ MASTO. Thank you, Chairman Cotton, and welcome to all our witnesses today.

I appreciate the Chairman suggesting a hearing to explore barriers to economic mobility in the United States. The Senate Banking Committee has jurisdiction over many of the most pressing issues facing Americans today—from housing, to lending, to transportation, and today we discuss how Congress can improve economic outcomes for children and families and entrepreneurs.

We want our children to grow up and become financially self-reliant. We want the children of renters to be able to own their own homes if they wish. And we want children whose parents struggled to put food on the table to be able to afford a full pantry and even a few meals out every month.

We want children who survived homelessness to grow up with an income adequate to not just pay the rent but save for their children's college education and their own retirement. We want workers retiring from one career to be able to open a small store and have it thrive.

Yet those dreams—the American Dream—are unattainable for too many. Parents who lack affordable bank accounts end up with financial products that can lead to a debt trap. As they struggle with bank fees, they may see their car repossessed, resulting in getting fired from their job and getting evicted from their home.

The average college senior graduates with more than $30,000 in debt, and total student debt nationwide has topped $1.5 trillion. And some college graduates cannot find jobs that pay enough to manage their crushing student loan debt. They delay starting a family, buying a home, and saving for retirement for a decade or more because of this.

An entrepreneur buys a franchise business but finds the business never earns as much as she was promised. As she struggles to keep her store in the black, she does it all on her own. She cannot afford to hire employees and pay them a living wage. That is wrong.

It is wrong that the ZIP Code where a child is born and grows up affects their future income and financial success more than the child's education, aptitude, or work ethic.

It is wrong that a lack of affordable financial products prevents families from building up savings to respond to a broken arm or a broken car without a major financial crisis.

It is wrong that corporations use noncompete clauses, union busting, and arbitration clauses to keep wages low and corporate profits high.

And it is wrong that high housing costs, lack of affordable child care, and inadequate transit restrain economic mobility for struggling families and young adults.

It is wrong that entrepreneurs who purchased a franchise—many of them immigrants, retirees, and veterans—were misled by unfair contracts, deceptive financial information, and nondisparagement clauses.

We need solutions. And we know many of them are already out there.

In their written testimonies today, the witnesses have suggested significant investment in education, health, and other public services. They want to empower workers and franchise owners. They recommend tackling monopolies and corporate concentrations that drive out competition and result in lower wages for workers.

We have seen how Government can protect homeowners, small business owners, and entrepreneurs from predatory and abusive practices and financial products.

I thank all of the witnesses for being here today. I look forward to hearing the testimonies, working with all of you as we move forward. In fact, I hope that, as Mr. Cotton said, what we are focusing here on Congress is how we ensure that everybody has the opportunity to achieve that American Dream.

So thank you.

Senator COTTON. Thank you, Senator Cortez Masto.

I would move to your opening statements at this point, but we are going to have a brief break in that order because Senator Cramer has to preside over the Senate in about 15 minutes, and I want to give him a chance to speak. Then we will come back to you for your opening testimony. Presiding officer duty is called a "duty" because the junior Senators have to do it all the time, not the senior Senators. But some Senators like it because it is the one time that you get called "President" around here.

So, Senator Cramer.

OPENING STATEMENT OF SENATOR KEVIN CRAMER

Senator CRAMER. I appreciate that, Mr. Chairman. It is also the one time that your chief of staff cannot get hold of you, so there are other benefits.

Anyway, thank you for accommodating that, and thanks to all of the witnesses for being here. And thanks for this important topic. I just want to say a couple things up front, put something in the record, and then hope I can get back before it is over, but I have my doubts.

Just so you know, I grew up in a home with a rural electric lineman daddy who actually quit high school after the 11th grade because he could make so much money being a rural electric lineman. Fortunately, today, through the IBEW and the rural electric cooperatives and others, they now get a little better training in advance of that.

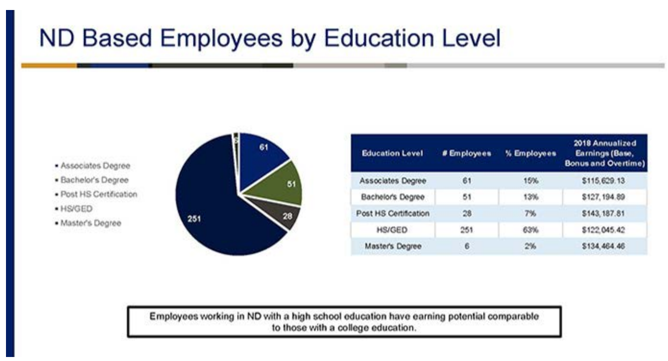
So those are my roots, and I come from a place in North Dakota where, frankly, an MBA is not nearly as valuable as a CDL. And we have an economy that really, I think, highlights some of what we hope to be able to talk about and maybe learn something about today.

I am always drawn back to that great line of Steve Martin's in a movie where he said, "It is easy to be a millionaire. First, get yourself a million bucks." Well, you know, that is not so easy. But the American Dream is alive and well, but we have two statistics in this country, two data points that are in conflict on a regular basis, and no more so than right now, and that is, we have a very low unemployment rate and we have a very low workforce participation rate. To me, that screams opportunity—if we just match all of our resources and assets and policies with an economy. And so I am looking forward to the testimony.

I wanted to put one thing into the record, Mr. Chairman, that I will be highlighting. This is the slide right here. This is a slide—and I have four slides that correspond, but I want to highlight this one. This is a slide that I asked one of the companies in North Dakota who has 400 employees to give me, because when they told me this, I had a hard time believing it. As you can see, it demonstrates the five different degree levels, education levels, and the annualized earnings base, bonus, and overtime, of course, and it shows you how they correspond. And it is a bit upside down compared to what we might think.

But you will notice, of course, that the post-high school certification student or graduate has the highest earning power in North Dakota at $143,000, more than the master's degree, more than the associate degree, more than the bachelor's degree. And I highlight that just to demonstrate that—I do believe the American Dream is alive and well, but we need to maybe emphasize a few things a little bit differently, whether it is in student loans, whether it is in education opportunities, perhaps as much as anything in our culture and how we talk around the kitchen table with our families. And I just hope—I am grateful for the opportunity to at least highlight one picture of the American Dream that is alive and well if, in fact, we can align our policies properly.

And with that, I would just ask for unanimous consent to place the slides in the record, and then I look forward to everybody's testimony.



Senator COTTON. All those slides will be placed in the record, and they really do tell a remarkable story, that the highest earning potential for this company in North Dakota is not college degree, it is not even an advanced degree, but a high school degree with a certification for some of the high-skilled labor that the North Dakota economy needs.

Senator COTTON. Thank you, Senator Cramer, and enjoy presiding over the Senate and the fascinating speeches you will hear there.

All right. Now we will go to the witness testimony.

Mr. Cass.

STATEMENT OF OREN M. CASS, SENIOR FELLOW, MANHATTAN INSTITUTE FOR POLICY RESEARCH

Mr. CASS. Thank you, Chairman Cotton, Ranking Member Cortez Masto, and Members of the Committee, for having me here today.

I want to start with where Senator Cotton started, which I think is exactly the right question when discussing the American Dream: What is it that Americans actually dream of? We tend to think especially here in Washington, that it is escaping their circumstances, attending a prestigious university, and perhaps doing a job like many of the ones here. But that is not, in fact, the case.

In 2017, the Pew Research Center studied the question of how Americans define the American Dream and found that economic concerns rank low. By far, the components of life most often deemed essential were "freedom of choice in how to live" and "having a good family life." Next came "retire comfortably" and "make valuable contributions to community." Last, and ranked essential by only one in nine Americans, was "become wealthy."

Another poll conducted by Pew in 2014 adds further perspective: 92 percent of Americans said that "financial stability" was more important to them than "moving up the income ladder."

Now, good economic outcomes obviously are a critical prerequisite to these priorities. Exercising freedom of choice in how to live is difficult without the capability to achieve self-sufficiency. Financial stability itself suggests a certain degree of labor market success. But, in general, the American people appear to have a much richer and more nuanced view of the determinants of their quality of life than do many of their leaders, who have tended to equate prosperity with growth, material living standards, and equality of opportunity on the economic ladder.

American politics often starts from the presumption that our goal is "equal opportunity" defined as "equality of life chances"—that is, where a child starts should have no bearing on where he ends up and that everyone should have an equal chance of arriving at any destination.

The problem is that that is plainly impossible in a world in which individuals possess different innate characteristics and grow up in different environments.

A more pragmatic vision of equal opportunity, more consistent with how Americans actually think about the American Dream, entails removing any public impediments that obstruct individuals from pursuing their goals. Unfortunately, we may have to accept that that will not get us as far as we would like.

Consider the findings of the Brookings Institution's Richard Reeves, who used data from more than 5,000 Americans born mostly in the 1980s and 1990s to compare the income quintile in which they were born to that which they ended up in as adults. So, for instance, what share of those born in the bottom 20 percent of the distribution ultimately reached the top 20 percent?

Family structure almost entirely dictated opportunity. For someone born in the bottom quintile to a married mother and raised by both parents, the odds of reaching the top quintile were higher than remaining in the bottom quintile. In fact, those children faced almost perfectly equal chances of ending in any of the five segments. Public impediments appeared to exert little influence.

But for someone born in the bottom quintile to a never-married mother, the odds of rising to the top quintile—5 percent—were one-tenth that of remaining in the bottom quintile—50 percent. The private impediment was almost insurmountable.

So in the face of dynamics like these, guaranteeing "equal opportunity" the way we so often speak about it would require implementation of public programs capable of counteracting all of life's disadvantages. And American policymakers have come to see education as the panacea capable of accomplishing that and so have embarked upon the quixotic quest of "college for all." This approach has been a mistake whose primary victims are precisely those it is intended to help—people who remain unlikely to emerge successfully from a high-school-to-college-to-career pipeline yet are offered no meaningful alternative.

The sad irony is that, in our attempt to deliver "equal opportunity," we have, in fact, constructed a public impediment to it. I thought the definition that Senator Cortez Masto provided as she was describing the American Dream was very telling, and it was absolutely not one that would require a college degree to achieve in this country.

If the aspirations of the American people—the real American Dream—required an equalization of life chances, then maybe we should continue tilting at that windmill. But, fortunately, they do not. Policymakers should focus instead on ensuring that every American has access to some minimum, absolute level of opportunity to achieve self-sufficiency, support a family, contribute to a community, and then provide to his children even greater opportunity. And they should be able to do that in safe, clean, connected communities free from crime and addiction.

Historically, someone who earned the basic level of education widely attainable within society, worked full-time, and formed a stable family could reasonably expect to achieve those things. And he could achieve them either by setting off for a new city or staying right near home. And I would predict that if we made that our focus, building that kind of foundation under our economy, we would in the long run achieve much higher levels of economic mobility than we are achieving today.

Now, as I alluded to, I think the way to start down this path is with dramatic reforms in education, shifting most of the money we spend subsidizing higher education for the people we expect to be our economy's winners toward other pathways that would more effectively bridge from high school to life as an adult and to careers that can achieve productive earnings perfectly sufficient to support a family and allow Americans to achieve the dream as they define it.

Thank you very much.

Senator COTTON. Dr. Levin.

STATEMENT OF YUVAL LEVIN, PH.D., DIRECTOR OF SOCIAL, CULTURAL, AND CONSTITUTIONAL STUDIES, AMERICAN ENTERPRISE INSTITUTE AND NATIONAL AFFAIRS

Mr. LEVIN. Chairman Cotton, Ranking Member Cortez Masto, Members of the Committee, thank you very much for the opportunity to testify today.

It is very encouraging to see this Committee take up the crucial question of economic mobility and seek to understand it from a variety of angles and perspectives.

I am sure I do not have much to add to what my esteemed fellow witnesses have to offer this morning, so maybe I can use these brief opening remarks to stress a couple of general points that I think ought to inform a discussion like this.

In my written testimony, I review some of the evidence regarding trends in economic mobility in the last few decades and find it discouraging in some key respects. The past few years have witnessed relatively strong economic growth and, with it, a modest and welcome uptick in various measures of mobility as well. But these have to be understood against a broader trend of fairly stagnant mobility.

I then take up some of the causes of diminished economic mobility and the question of whether and how public policy could make a difference.

Some barriers to mobility are likely to be very difficult for public policy to influence constructively, especially the decay of some key social institutions that are essential to flourishing and, therefore, also to rising living standards. But there are some obstacles that could be more open to product interventions, and given our time constraints, I want to quickly mention just one set of such obstacles here.

Simply put, it involves the rising cost of living for working families. That may seem a strange subject on which to raise alarms since inflation has been remarkably low for more than three decades in America. But while that is true of general inflation, household costs have actually risen dramatically in three areas of particular importance to economic mobility. We might call these the "three H's": health care, housing, and higher education.

These three areas are of enormous importance to American families who are striving to improve their living standards. Health care and housing are often essentially unavoidable expenses, while higher education is among the most effective means of securing a middle-class lifestyle for the rising generation. And yet in all three areas, we have seen prices run far ahead of value for decades.

In all three areas, too, public policy has played a major role in that increase in costs by simultaneously restricting supply and subsidizing demand. That combination has predictable consequences: It increases prices and, therefore, costs.

In health care, the supply restrictions have especially had to do with the regulation of health insurance in ways that have restricted options and competition and so have closed off potential avenues for lowering costs. The subsidization of demand, meanwhile, has consisted of the exceedingly generous tax subsidy for employer-provided insurance, the enormous growth of Medicaid, and new forms of subsidy in the individual market.

In housing, we have seen local, State, and Federal policies interact in ways that in many places have restricted supply through tighter zoning while subsidizing demand through tax benefits, home loan subsidies, and various kinds of first-time-buyer benefits. Obviously, there was a huge crash in this market a decade ago, but the basic pattern of Government intervention did not change all that much in the wake of that disaster.

In higher education, the restriction of supply happens especially through the overly narrow accreditation process that limits our definition of higher education and so limits options for people seeking a better life. And the subsidization of demand has happened especially through student loans and assorted other tax benefits.

Each of these policies is plausibly defensible in itself, of course. Some of them are much more than defensible. But the sum of all of this has been a lot of inflation in three areas that are crucial to the lives of vast swaths of our society who are trying to rise.

A cost-of-living agenda that tried to counteract this tendency should have a lot of appeal across party lines. There are steps that could be taken on both the supply and the demand sides of each of these sectors of the economy, as I suggest in my written testimony.

There are many other obstacles to think about here, of course, and my testimony gets at some of those. But I want to just close by commending the Committee for taking up this very important subject in the way that it is doing so. Mobility and opportunity matters enormously. It has to be a priority for our economic policy, and Americans have often understood our National Government in particular to be rightly devoted to that important cause.

In a message to Congress on the Fourth of July of 1861, amid the painful early setbacks of the Civil War, Abraham Lincoln tried to articulate what made that struggle worthwhile. And when it came to describing what we valued in our Government, Lincoln said this:

> On the side of the Union it is a struggle for maintaining in the world that form and substance of Government whose leading object is to elevate the condition of men—to lift artificial weights from all shoulders, to clear the paths of laudable pursuit for all, to afford all an unfettered start and a fair chance, in the race of life.

America has often been gloriously successful in advancing that cause, but it has been noticeably less so in recent decades. We have ignored that fact for too long. And I commend this Subcommittee for turning its attention to this challenge, and thank you for the opportunity of letting me testify.

Senator COTTON. Thank you.

Mr. Ponnuru.

STATEMENT OF RAMESH PONNURU, VISITING FELLOW, AMERICAN ENTERPRISE INSTITUTE

Mr. PONNURU. Chairman Cotton, Ranking Member Cortez Masto, and distinguished Members of the Committee, thank you for this opportunity to testify on this important topic so central to America's historic self-conception.

I wish to address absolute economic mobility, and I have four main points to make about it.

The first is that our record for most of the period since the turn of the millennium has been poor. Median family income adjusted for inflation rose through the 1970s, 1980s, and 1990s, but then the numbers turned much less reassuring. Median family income of 2014 was actually lower in inflation-adjusted terms than it was in 2000. Over the last few years, the trends have been positive and could become better still if the expansion continues, but we have no reason for complacency.

Second, effective countercyclical policy is crucial for upward mobility. Our poor performance over the last two decades had a lot to do with the sharp recession that began in December 2007 and the agonizingly slow recovery from it. Median family income dropped by more than 7 percent from 2007 to 2011, the sharpest decline since we started tracking that data. And it did not recover completely for 8 years. Stronger anti-recession policies are, therefore, key to increasing upward mobility.

The Federal Reserve has primary responsibility for countercyclical policy and deserves credit for several steps that it took in response to the Great Recession. But there are some reasons for worry. Whether its current regime is capable of handling the next recession, particularly when it relies on lowering interest rates that are already extremely low, is a serious question. Its record of consistently undershooting its own inflation target over the last decade also gives some reasons for concern. The Federal Reserve needs to seriously consider whether its current approach biases it toward excessively tight monetary policy that makes recessions more severe and recoveries weaker.

Third, mobility requires higher economic growth. Even before the Great Recession, economic growth was slower than it had been during past expansions, and it was the combination of the sharp recession and this slow growth that made the overall economic record of 2000 to 2014 so frustrating for most Americans. Reforms that would raise the rate of economic growth over the long run should be a high priority. In my written testimony, I mention some areas that hold promise, including changes to our tax laws with respect to investment and changes to our immigration policies.

Fourth, and finally, geographic mobility enables economic mobility. A common way that Americans have historically bettered their lot is by picking up and moving to places with more opportunities for them. But they have been doing a lot less of that in recent years. Interstate migration rates have been falling since 1980, and that trend has reduced wage growth, productivity, and employment rates. At the same time it has increased the length of spells of unemployment, and it has increased the variation in income among regions of the country.

Public policy has likely played a role in these changes. The restrictive zoning laws that Dr. Levin mentioned in many jurisdictions, especially ones with rapid economic growth, have made housing expensive and thus reduced the ability of Americans in slower-growing regions to move there.

The expansion of occupational licensure by State governments also works against mobility. Relocating in a new State may require the acquisition of a new license in order to work, and that can take time and money.

The Federal Government may be able to exert a positive or at least a counteracting influence in some of these areas. But even national attention to the mobility problem may spur beneficial steps.

As this brief review suggests, increasing mobility is a multifaceted challenge. But if the work is difficult, the potential rewards are substantial and worth the seeking.

My thanks again to the Committee for the invitation to speak.

Senator COTTON. Thank you.

Ms. Lee.

STATEMENT OF THEA M. LEE, PRESIDENT, ECONOMIC POLICY INSTITUTE

Ms. LEE. Thank you, Chairman Cotton, Ranking Member Cortez Masto, Members of the Subcommittee, for the opportunity to speak to you today and for organizing this hearing on this important topic of economic mobility and the American Dream.

What we are talking about here today is how policy choices over recent decades have eroded access to the American Dream for too many Americans and also how we can use policy to restore opportunity and mobility for working people.

I think we all treasure the concept of the American Dream, the idea of continuous upward progress generation after generation. And the key message that I want to bring today is that the lack of economic opportunity for low-wage and middle-class American families is not an accident of history, not a nameless economic force against which we find ourselves powerless. Rather, the highly unequal distribution of resources and opportunities within our society is a direct result of policy choices that, together, have had the effect of weakening the power of workers to defend their rights in the workplace and in the political arena, thereby tilting the playing field in favor of moneyed and corporate interests.

Moreover—and this is a key point—historic and ongoing discrimination in many forms and in many areas—including education, housing, and the workplace—has created obstacles to economic advancement for working women, workers of color, LGBTQ workers, and their families.

So while the subject of this hearing is economic policy, we are really here to discuss something much more fundamental: the idea of America as a Nation, who we are, who we want to be, and whether we continue to strive to build a vibrant dynamic society filled with opportunity for all or throw in the towel.

Inequality and the structural impediments to upward mobility are not just unfair—they are also economically inefficient. They represent wasted talent, potential output, and intellectual contributions, and that should create the urgency that we face today and that I sense from my fellow witnesses. I appreciate the opportunity to be here with others.

So we made a distinction between mobility versus opportunity, but we see it in the context of growing inequality and wage stagnation, as some of my fellow witnesses have mentioned. And a huge amount of mobility would be required to counteract the unprecedented high and growing levels of outright income and wealth inequality we are now experiencing in the United States and we have been experiencing for about four decades. That mobility just is not there.

So the challenge is, in the context of the growth of inequality and stagnation of wages for the bottom and middle-class workers, we need to create even stronger pathways, and we have not seen them in past decades. And those challenges that workers face are exacerbated by some of the bad policy choices we have made and also by some of the employer trends toward disempowering workers from their very first day on the job. These contracts that require as a condition of employment that workers sign away their right to class action or submit to forced arbitration or noncompete agreements;

also employee misclassification, where workers are denied their right to be treated as employees and instead are treated as independent contractors; and also the attacks on unions.

But given all these economic trends, we see lobbying efforts by profitable companies to renege on their obligations as employers to their employees and to use the excuse of the gig economy and the internet platforms trying to take power away from workers.

And as Mr. Miller's testimony will show, even for small businesses and franchise owners, the concentration of wealth and political power creates inefficient and often unfair outcomes.

We know that the most important pathway to the middle class is a healthy labor market that provides sufficient employment opportunities with good pay and benefits that are equally accessible to all people. Government, individuals, and institutions each play a role in creating pathways to the middle class through the labor market.

We see the American people are working harder than ever, sometimes at two or three jobs, with more education than previous generations, and in an economy that is wealthier and more productive than in the past. And yet they face these challenges and the policies that have eroded their barganing power.

So the key policy recommendations that we would put forward as addressing some of these concerns include raising the minimum wage, reforming labor law to ensure that workers have the right to form unions and bargain collectively, making sure—and I agree with Mr. Ponnuru on this—that Federal Reserve policy is fairly balancing the risks to inflation and trying to achieve full employment, and then making sure that Government is using fiscal policy not just to address economic downturns but also to target Government spending toward addressing structural needs, like infrastructure investment and employment programs targeted at poorer communities; renewing our attention to the public education system; and last, but not least, address longstanding and ongoing racial inequities in housing, employment, and wealth.

So, with that, I look forward to your questions, and I thank you again for the opportunity to be here today.

Senator COTTON. Thank you, Ms. Lee.

Mr. Miller.

STATEMENT OF KEITH R. MILLER, PRINCIPAL, FRANCHISEE ADVOCACY CONSULTING

Mr. MILLER. Chairman Cotton, Ranking Member Cortez Masto, and Members of the Committee, thank you for your time today.

Today I will speak specifically about the franchise industry. The franchise business model itself is a brilliant model and one I support. However, because of little transparency and oversight, it is also an industry with far too many examples of predatory franchise companies that take advantage of prospective entrepreneurs.

Most believe this large sector is heavily regulated. The FTC does regulate pre-sale disclosure through the Franchise Rule and requires prospective franchisees receive a Franchise Disclosure Document (FDD). But I ask, how many of you actually knew that the FTC does not even collect this disclosure, much less review it.

Franchise Grade looked at 1,900 franchise systems, using disclosure information from a 5-year period, and noted that while 169,000 units had opened, almost 139,000 units had closed, for a net gain of less than 30,000. If this high level of failure were happening in the private market, it would be bad enough. But the SBA loan guarantee programs are enabling this failure and fraud. In 2013, the GAO reported that during the previous 10 years, the SBA made guaranteed payments on approximately 28 percent of 7(a) franchise loans.

Amin Abdelkarim immigrated from Egypt to Dallas and worked two jobs at DFW to save in search of his American Dream. He purchased a Dickey's Barbecue franchise. He was given a disclosure document and a spreadsheet showing estimated startup costs. The estimates were grossly incorrect, and his startup capital was spent getting open. He opened his business in August of 2018, and he contacted me 1 month later. He was already broke and could not make the payment to a 7(a) loan. His message to me was: "In a few weeks, I will find myself, my disabled wife, and my 89-year-old mother-in-law in the street, with no house, no car, and no money."

Here is the problem in the industry: Far too many profit from the sale of a franchise, yet far too few, if any, are held accountable for the success of the franchise purchaser.

Mark Shor retired from his IT job and bought an Experimac franchise in Henderson, Nevada. The franchisor directed him to a specific loan broker that provided him with the projection spreadsheet that showed revenue of nearly $700,000 in year one and $995,400 in year two. Both, if you look at today's disclosure document, are well above the numbers in that. He is now surviving by dipping monthly into his retirement to pay his SBA loan.

Michael Hataway is a Complete Nutrition franchisee in Reno. Since the franchisor has pulled all their support, wrongly sent out an email to his customers that his location has been sold, and aggressively marketed online sales, his sales have crashed. His finances are in shambles, and he is heading toward default.

Jamie Stephens is another Complete Nutrition franchisee with stores in North Dakota and Minnesota. He has SBA loans totaling $1.5 million and has the same issues with his franchisor. But do not worry about the franchisor. They still kept their $49,500 franchise fee.

Finally, Huntington Learning Centers. The Inspector General at SBA found that 7(a) loans were made with inflated revenue projections. Bob Spada from Connecticut was one such franchisee. He was again directed to a specific loan consultant to work with and applied for a loan. He received a $300,000 loan on a $500,000 first-year projection. Later he found out that actual for an average center in the first year was $249,000. As he dug for the reasons for this high projection, he discovered the devious means. To qualify for that $300,000 loan, he would need about a $75,000 profit in that first year to meet the required debt service coverage ratio. To reach that profit level, and reverse engineering the numbers, you come up with $500,000 in revenue. Bob was forced into bankruptcy, total losses of his mortgage, equity loan, and credit cards more than doubled the SBA loan. So who accounts for those losses to the economy?

I appreciate the Banking Committee's consideration of ways to curb some of these abuses and have provided some corrective steps to clean up the industry. I appreciate Ranking Member Cortez Masto specifically on her commitment for SBA transparency lending.

In summary, the franchise business model can be, and should be, a model for economic mobility and realizing the American Dream. However, leaving the industry to police itself is not working, and destroying lives while some profit. There is no reason for this, and access to SBA money should be the model of transparency for the industry, one that ensures the best underwriting procedures to those in search of the American Dream.

Thank you.

Senator COTTON. Thank you, Mr. Miller.

I want to begin the questions by exploring the relationship between wages and employment on the one hand and immigration on the other hand. The full Committee had Federal Reserve Chairman Jay Powell testify last week. One thing he noted is what he called "the widening gap in the economic status and prospects between those with a college degree and those without one." One example he used in particular is the percent of American men who had a job in 1967 versus 2017 by education level.

In 1967, men with a college degree were 95 percent employed; in 2017, 90 percent employed. So only a 5-percent decline.

High school education, however, went from 95 percent employed—the same as those with college degrees—down to 80 percent. And for those without high school, in 1967 90 percent employed, all the way down to only 70 percent employed.

Now, I have a chart behind me that indicates immigration population and the share of immigrants over time. I would note, of course, the vast majority of immigrants throughout our history have been unskilled or low-skilled workers; today only 1 in 14 persons are admitted to this country and given a green card because of their job skills, education, and so forth. That is to say nothing of the millions of temporary non-immigrant workers we have in our economy and to say nothing of the million of illegal immigrant workers we have either.

Mr. Ponnuru, when you look at this chart and you see the decline in immigration levels starting roughly around the late 1930s, and due in part to the Depression, obviously, due in part to the 1924 immigration law, continuing into the 1970s, a period after World War II of great prosperity, and then you see the increases, rapid increases, in fact, starting in the 1970s, a result in part of the 1965 law, what relationship do you see on the one hand between wage declines for working-class Americans, job prospects for working-class Americans, and on the other hand large increases in unskilled and low-skilled immigration?

Could you turn your——

Mr. PONNURU. Thank you. Well, I think that the level of immigration that we have had and the basis on which we have admitted the immigrants have not been well geared toward increasing American prosperity, and particularly at the low end of the labor market. There is some evidence to suggest that a large influx of low-wage labor is going to have a depressing effect at that end of the market; with a shift in the basis of immigration toward the recruitment of people who we need for higher-skilled tasks would not have that kind of effect.

And so there are, I think, two pathways by which a different immigration policy would help the American economy. One is by increasing our overall productivity levels and changing our average skill level and the other is by relieving some of that pressure at the low end of the labor market.

Senator COTTON. So I have introduced legislation that would revamp our legal immigration system, the way we grant green cards to foreign nationals in this country, that would shift it substantially away from extended family reunification or the diversity lottery and toward high-skilled workers who already have job offers that pay more than the local economy average, that speak English well, that have advanced degrees and so on and so forth. What kind of economic impact do you think we would see both overall and kind of the abstract terms? What would that mean for Americans with high school degrees or with less than high school degrees?

Mr. PONNURU. I think it would have a positive effect. It would be good for the GDP numbers, and it would also make it possible for people at the lower rungs of the economic ladder to make upward progress.

Senator COTTON. OK. Thank you.

I will now recognize Senator Cortez Masto. I think this is a theme to which I will return later, though.

Senator CORTEZ MASTO. Thank you.

Mr. Miller, I would like to explore with you the franchisor/franchisee arrangement. Can you talk a little bit about the FDDs that are utilized? My understanding is they are notoriously complicated and imbalanced legal documents. Talk to me about how we can improve the FDDs and related contracts and prevent some of the mistreatment that you just talked about with respect to the franchise owners.

Mr. MILLER. Well, in one part, the document is so huge, the disclosure document. It is 500 pages to 1,000 pages. So you have got to remember a lot of what the industry advertises to for those seeking the American Dream of, you know, "be your own boss, no experience necessary" proven business models. So you are often reaching out to people who are not, you know, having MBAs, and yet you are giving them this document that is 500 to 1,000 pages. So trying to find the nuggets of information in there is very difficult.

You also have the financial performance part of that document, which is not a required piece. A franchisor can just say, "We choose not to put anything in the financial representation part." That can be left out.

Senator CORTEZ MASTO. And explain that, if you would, a little bit more. For somebody who wants to start a business, they are going to have to take a loan out and start as a franchisee. But wouldn't it be helpful for them to have from the franchise owner, to receive in that FDD actual revenue, store closing information that would help them as well as the SBA that is going to be giving them the loan to see how successful this franchise company could be?

Mr. MILLER. Well, there are two parts to that. First of all, obviously, if it is a franchise business model that is supposed to be proven, there is history and data. It is not like I am going up and opening Keith's Subs tomorrow and have no history. So there is history there. And, again, this data is not required.

The SBA requires you to come up with first-year projections. Well, first-year projections have to start with some kind of revenue projection. Every franchise company knows what sales are happening in each of their outlets. That is how they collect royalties. So why are we not requiring, when people are accessing Government/taxpayer-guaranteed money this first-year revenue number that everybody has? And what makes it worse, the second step is if you notice in my examples almost every one of these people were assigned to a hand-picked specific loan broker or consultant that the franchisor gave them. These people are giving revenue numbers outside of the disclosure document and not violating any disclosure law by doing that.

I have copies of spreadsheets that people have gotten from these loan brokers. This is the information that is going on the SBA loan, and this is how they are qualifying. These loan brokers, as I said, have actually figured out how to reverse engineer, if you are taking out X amount of a loan, how much profit you have to show to get that loan, and then figure out how much revenue they have to show to get that.

Senator CORTEZ MASTO. And the franchisee does not see that information because that is shared between the franchisor and the broker?

Mr. MILLER. Well, no, the broker will probably show it to the franchisee, but a third step, I guess, in there is—and the SBA actually presented this at a conference—that franchisors, to help loans get approved, can talk to the bank, but before they do so, sign a confidentiality agreement so they do not violate any of the disclosure laws. I cannot think of anything in the world where the borrower who is signing on the dotted line does not know every bit of data that went into that decision.

Senator CORTEZ MASTO. And then the financial disclosure documents or the franchise disclosure documents, they also contain nondisparagement clauses. Explain how that impacts the actual individual owner.

Mr. MILLER. So people always talk about doing due diligence in the industry before they buy a franchise. Well, one of those parts of the due diligence is calling existing owners. Those franchise agreements have that nondisparagement clause in it. I can tell you, if I am in one of my stores and somebody calls me and starts asking questions, and let us say I have a negative experience, am I going to really say so? I do not know who is on the other end of the line. And while that may not itself cause the termination, it is not hard to be more difficult on a franchisee.

The second part of the due diligence would be following up with past franchise owners who have gotten out of the system, and you have two problems there. Number one, the list in the disclosure document shows their store location. Well, they are ex-franchisees.

They are not at that store location anymore, so you do not have access to reach them, number one. And, number two, if they have had a bad experience and been terminated, there is usually nondisclosure clauses as part of that and, therefore, they cannot comment or say anything.

Senator CORTEZ MASTO. Thank you.

Senator COTTON. Senator Tillis.

Senator TILLIS. Thank you, Mr. Chairman. Thank you all for being here.

This is kind of personal to me. About a month ago, I was down in northern Florida, coming back from Sea Island, and when I go down to Jacksonville—that is where I grew up. I went to the trailer park I grew up in. The reason I go there is to try and find some kid that is like me: 19-years old, living in a trailer park, not going to high school, trying to figure out a way to get out of that circumstance; six brothers—five brothers and sisters, three of which never graduated high school; two got their GEDs; two of us went on to get a college degree. I did after attending two technical schools and three other schools and getting my degree when I was 36-years old.

I did that in an environment in the 1980s, beginning in the 1980s, because we actually had optimism, and we took it on ourselves to get the degrees, get the additional education, and then move up. So I go to that trailer park trying to find a 17-year-old or 18-year-old to say, “I did it. You can, too.” So what I am really interested in are the policies that are going to make sure that those teenagers coming up today have the same opportunities that we do.

And I will as a footnote, for my five brothers and sisters, the two that went to get their GED, the one that never graduated high school, they are all living happy, stable lives.

Mr. Cass, you mentioned in some of the research from, I think it was, Pew that we get so obsessed with mobility, but it sounds like to me at least in one of those reports there was more of a focus on stability. Can you tell me a little bit more about that?

Mr. CASS. Yeah, thank you for that question and for that background, which I think is actually really illustrative of the theme that I want to emphasize. When most Americans—and, of course, we cannot speak of all Americans, but, generally speaking, when Americans think about their own goals and dreams for themselves, their children, it is those things. It is to have a stable life, to be able to support themselves, to have a good family, and for some people, particularly who have strong academic aptitude, that college education makes tremendous sense as part of that.

The problem is there are a lot of people for whom college is unlikely to be the best pathway to that, and when by default we say for everybody, including the children who might be growing up in a trailer park, even in a very wealthy community, there are plenty of kids who are not going to be very successful in college. We know that from the data.

Senator TILLIS. I actually want to tap into something else, because even upward mobility with respect to education—I think of that slide that talked about a business in South Dakota, Senator Cramer’s example, is a good one, where you make more money with a CDL than you make with an MBA. That may not be true over the course of time, but it is true right now given the economic dynamics in South Dakota.

I guess I am trying to figure out how to—one of the things we need to do, number one, does anybody on the panel think that bigger Government and smaller corporations are the solution to this problem? Ms. Lee?

Ms. LEE. Well, I think there is certainly a role for a strong Government that is focused on fairness and equality. Not so much smaller corporations, but I think when we do not address concentration of market power, we give too much power, inordinate power to corporations, and sometimes they use that in their own interests and against that of working people.

Senator TILLIS. I for one believe that we came out—fortunately, I was not 18 in 1968. I was 18 in 1978. And it is actually when our country took a very different turn in terms of the relationship of Government to the private sector, so I think we need to be very careful to think a big-gov solution on tracking people and education or controlling the size of corporations or getting them to a point where they need to be broken up I think are absolutely at odds with what we are trying to accomplish with this hearing and for opportunities for people who have my same circumstances, and as Mr. Cass rightly pointed out, even people in high-net-worth households.

So I would just say that I do believe that we need to find more opportunities, that Government needs to play a role. But what I absolutely reject is—I will give you this last story. It is somebody I spoke with yesterday, someone who immigrated from India in the 1970s because he concluded he could not be a doctor in that country because he was not of the right caste and he did not have the right connections and it is a big government in India. So he decided to come to the United States where he could study medicine and become a doctor, and he did. That is another realization of an American Dream.

So I think as we start looking and crafting solutions for how we actually continue to have that opportunity for stability, opportunity for mobility, count me in on anything that gets Government out of the way but inspires people to realize the same dream I did.

Thank you, Mr. Cotton, Senator Cotton, Chairman Cotton.

Senator COTTON. Senator Smith.

Senator SMITH. Thank you, Chair Cotton, and thank you Ranking Member Cortez Masto. And thanks to all of you for being here.

Ms. Lee, you say in your testimony that the most important path to the middle class is a healthy labor market that provides employment opportunities with good pay and benefits equally available to all. Could you talk a little bit about how we ought to think about the trade negotiations that we are currently looking hard at, especially USMCA, and how decisions around USMCA can contribute or not to that healthy labor market that creates opportunities for everyone?

Ms. LEE. Thank you so much, Senator Smith, for the question. The healthy labor market has so many components to it. One is the Federal Reserve, but the other is how the United States engages in the global economy and what are the set of rules that we put in place that are balancing the interests of working people, the environment, consumers, and businesses. Certainly, the USMCA negotiations, the renegotiation of NAFTA, has addressed some of those issues around strengthening the worker rights provisions in NAFTA and strengthening the rule of origin. And it has not addressed other issues around the price of pharmaceutical products and some of the environmental protections.

But it is part of this ongoing conversation that we are having about how do we engage in the global economy. What we have not done in the past is put American workers and manufacturing and communities at the center of our trade policy. We have been too focused on corporate profits and outsourcing opportunities and not enough on a healthy domestic manufacturing sector and all the kinds of supports that manufacturing needs, in terms of tax treatment, training opportunities, and infrastructure. We have had failures domestically as well as in trade policy. If the United States wants to be a global leader in trade in 2019 and 2020 and beyond, we cannot do that by cheapskating infrastructure, skills, and educational opportunities. We need to have basic rules in place that are encouraging exports and domestic production and not outsourcing.

Senator SMITH. Thank you very much. So, really, you are saying that in our overall goal of having a healthy labor market in the United States, which is going to create the kind of mobility and also shared opportunity, that we can accomplish that with good, strong trade deals but that put American workers at the—you know, and that strong labor market not as an afterthought but as a forethought in the way that we negotiate these deals.

Ms. LEE. Exactly. I think thoughtful trade policies that put workers, American manufacturing, and domestic producers at the center are an essential, but not the only, part of a healthy labor market.

Senator SMITH. Thank you.

Now, this is such an interesting topic. I want to go to another issue. You all have recently done some looking at what is going on with teachers and teacher shortages. This is something—just the other day I heard from Minnesota's superintendents who are describing at this time of the year they are looking to fill jobs in teaching professions, and this is the case across the board, rural areas, small towns, and the big cities. They are barely getting a one-to-one application pool for these open positions, and so it is a significant issue across all areas. And so I am very concerned about this.

Could you talk a little bit in the short time that I have about what you see contributing to this and what we ought to be doing to think about this as we talk about how important education is as a component of mobility and opportunity?

Ms. LEE. Yes, thank you so much. What the Economic Policy Institute research has shown is that there is a real wage gap between teachers and people with comparable education experience in the private sector, around 17 percent on a national basis. It is much higher in certain States. Over time, States have been undercutting teacher pay, and then they are concerned when there is a teacher shortage, and they cannot find the teachers they need. These are people that we are entrusting with our children's education. I think we have all agreed that this is an essential part of economic mobility and opportunity. If we want to attract the very best people into the teaching profession, we need to make sure we are paying them at least as much as we pay people with comparable educational backgrounds in other sectors. This will take a national commitment to addressing the shortfall in teacher pay, and that will go a long way.

Also, we need to give teachers the support they need at school in other areas, too. We need to invest in a safe and healthy school environment with adequate support staff around social services and so on——

Senator SMITH. Mental health.

Ms. LEE. Mental health, absolutely, in schools. Thank you.

Senator SMITH. Thank you very much.

Thank you, Mr. Chair.

Senator COTTON. Senator Sasse.

Senator SASSE. Thank you, Mr. Chairman and Ranking Member, for holding this hearing. I think this is one of the most important topics that we do not consider nearly enough around here. And just to underscore one of the really important things that has been said already, Dr. Levin, your point about median household experience at a consumption level with inflation and, in particular, health care, higher education, and housing, and the point you made about restricted supply and subsidized demand inevitably producing inflation, which is unsustainable and unjustifiable in those sectors, and all sort of money equality where the consumer is not actually empowered in that decisionmaking equation. So I think that alone makes this hearing worth having, Mr. Chairman.

I would love to hear a few of you debate the future of the median worker experience over the next decade, if you would. In my neighboring State of Wyoming—we do not have exactly vacation destinations that have entire communities that look like Jackson Hole. But in Wyoming, there is now a shorthand that a lot of people live in the broader county around Jackson Hole, in Jackson proper, where they say that almost everybody who lives in Jackson or who visits Jackson is either a three-house or a three-income person. You have got the people who live in Jackson as one of their two or three or four housing destinations in life, or you have people in the uberization economy, to put it broadly, that are cobbling together wages from a whole bunch of different jobs. Absent big debates right here about policy changes—and those are important debates that flow from this conversation, but I would love to hear you all speculate on what do you think the median worker experience is, duration at a job, combination of different income sources, 10 years from today. Mr. Cass, can we start with you?

Mr. CASS. The median worker experience is certainly a single full-time job.

Senator SASSE. In 2030?

Mr. CASS. Yes. I mean, it is—the share that is working multiple jobs is so low now that to reach a majority by 2030 would be extraordinary. And the same goes with respect to the gig economy where people who are genuinely using that as their primary income as opposed to a supplement or a sort of flexibility is extraordinarily low. So I do not see that sort of shift reaching the median as quickly as 2030. I think all of the trend lines absent policy change point to an ever greater divide in our labor market between a higher end that consists of primarily college-educated people earning higher incomes in single typical jobs and everyone else who has not been given the opportunity to develop the skills to work in that kind of job and that is more likely to find less stable, lower-paying employment.

Senator SASSE. Dr. Levin, let us just go down the table.

Mr. LEVIN. Well, thanks for the question. I think it is a very important question to raise, and it points to a pattern that I would describe as a kind of bifurcated concentration where we have in a lot of areas in American life, and not just in terms of income but in a lot of the ways our cultures lives now, too, we have concentration at the top and at the bottom, and the median just matters less. It describes less than we would imagine. There are fewer people near the median than there might have been in the America of the middle of the 20th century.

I do think that it is easy to overstate the transformation and the direction of the gig economy, which at least for now is not really happening in the economic data just yet. It is easy to imagine that could happen, that could become transformative, but I do agree that it is likely that in 20 years the median worker is still a full-time employed worker. But, again, because the median matters less, I think we have to think about how to make opportunities available to people for whom the way to be in the upper concentration as opposed to the lower now is basically now a college degree. And there have to be more options than that because a college degree is not and cannot be the only way to move up in American society.

And I think the Federal Government has a lot of say over what other options exist through the kind of power that it exercises over the accreditation of higher education, informal power through student loans and the rest of it, but enormous power. And we have to make it a priority to open up more options for people after high school and to think of the step after high school as the first step into adult life rather than thinking of college as just 13th grade and that is what you do when you graduate. That is not what most people do when they graduate. It does not need to be. And there are ways to give people other opportunities, other ways of moving forward, that right now, frankly, Federal policy is standing in the way of in a lot of ways.

Senator SASSE. Mr. Ponnuru?

Mr. PONNURU. So I agree with the things that have been said so far. In terms of the percentage of American workers with multiple jobs, the latest number is that it is about 5 percent. It has moved in a very narrow range. It is actually a little bit down from where it was 25 years ago. So I think that the median worker is going to be somebody with one full-time job.

I think one interesting question which is policy dependent is going to be: To what extent is that worker dependent on his job for nonwage benefits? What percentage of his compensation will be wages and what percentage will be benefits? I think that the Government plays a big role in affecting that, and not always a positive one.

Senator SASSE. Mr. Chairman, could I ask for one extra minute so Ms. Lee can have a shot at this, too?

Senator COTTON. By all means.

Senator SASSE. Thank you.

Ms. LEE. Thank you, Senator Sasse, for the question. I think it is an excellent question, and I would say it depends on the path we take and that you take as a legislative body, that if we continue on our current path, we could end up with more bifurcation between the three-house or the three-job people, and that kind of polarization in the labor market where you have a small number of very, very wealthy people and a large number of people who cannot afford sometimes to get to work or child care or health care, and that is something which I think should trouble us.

So the questions that we have, I think, in terms of policy choices are whether as labor markets evolve, as technology changes, whether we give employers more and more power to undermine workers' bargaining power through forced arbitration, noncompete, employee misclassification, or whether we make sure that workers can really exercise their voice at work, their rights that we have, symmetry of information and disclosure, the kinds of issues that Mr. Miller raised.

So I think those are really important decision points that you all have to make as to where we end up 10 years from now.

Senator COTTON. We will go to the second round of questioning starting with Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you.

Let me follow up on that, Ms. Lee, because I think this is an important topic. So I come from Nevada. It is a right-to-work State, but we have strong organized labor. In fact, we have in Nevada one of the smallest gender pay gaps in the country. There is still a group, but it is smaller. And it is partly because of our strong union presence.

I saw a study. According to the Pew Charitable Trust, women in unions make 88 percent of what men earn compared with the 81 percent that women make outside unions.

So, in addition to shrinking that pay gap, I guess my question to you is: How do unions improve the financial status of low-wage and middle-class families and give that worker power back? What are the benefits that we see? Because too often I see our unions are just being attacked or denigrated, and really what they are doing is fighting for those middle-class and working families.

Ms. LEE. Thank you so much for the question, Senator Cortez Masto. Unions do close the race and gender pay gap, and partly it is because they make sure that workers are treated equally. There is a certain amount of fairness at the workplace that is statistically proven in union workplaces. And unions actually help non-union workers as well as union workers. It is an interesting fact. In States with higher union density, the wages for non-union workers are also higher because employers are operating in that competitive environment.

But the value of a union, to individual workers and employers, and to the economy, is that it provides a voice and a channel for workers, a democratic voice for workers, and it provides countervailing power. So if we think about the evolution of the U.S. economy over the last 20 or 30 years where there is more and more wealth amassed in a small number of individuals, and corporations are getting bigger and more powerful, who stands up for working people? A union is the countervailing power and the countervailing voice for working people. And as unions have been attacked and denigrated and weakened and eroded, we have actually seen the erosion of the middle class at the same time. So you can superimpose the decline of unions with the decline of the middle class in the United States over the last couple of decades.

Congress does have an opportunity to rebuild that and also to modernize our labor laws as we come into a new era. We do not have the labor market that we had 75 years ago. Our labor laws need to evolve to make sure that whatever kinds of employment opportunities people have, that they can exercise their voice at work. They can come together with their co-workers to exercise that right. So I am happy to see that Congress is beginning to take that up.

Senator CORTEZ MASTO. Thank you.

Mr. Ponnuru, let me ask you, do you believe that immigrant labor is displacing and/or lowering the wages for workers on our cattle ranches and farms in this country?

Mr. PONNURU. I think that there is some evidence, although it is disputed, that particularly for people without high school diplomas, immigration has had a negative effect on wages. Whether that is the case in every sector of the economy and every place, of course, is a different question. But I think that, one, there is some evidence and, two, it stands to reason that a larger supply will tend to reduce the price—in this case, the price of labor.

Senator CORTEZ MASTO. Yeah, and I would be curious to see the data that you have, because I have not seen that data, and I will tell you—and, Ms. Lee, I will have you answer this as well. Come to Nevada. Talk to our farmers and cattle ranchers. This is the first thing I hear, is that there are individuals that—they open it up to Americans or citizens, whatever you want to say, and they do not want to do these jobs. And so they are having immigrant labor coming in to do the jobs, and they are paying them very well.

And so that is what I see in Nevada. I do not see a displacement. I do not see a lowering of wages for immigrants. In fact, I see just the opposite, that the immigration in this country has contributed to our economy, and it does not displace workers.

Ms. Lee, I am curious to see what data or information you——

Ms. LEE. I can provide some citations, but I think over time the empirical evidence about the impact of immigrants on the U.S. workforce has changed, and we do not see the negative impact that we used to see. One of the key things, I think, is how we treat immigrant workers. Unscrupulous employers can take advantage of immigrants without legal status to undermine wages and to treat workers as disposable. They can call the immigration services if those workers try to organize a union or ask for a raise or ask for a bathroom break or safety goggles. That is more the problem than it is the number of immigrants or even the education status of those immigrants.

Senator CORTEZ MASTO. Thank you.

Senator COTTON. So unscrupulous employers who want to exploit immigrant labor is a real problem. That is one reason why I support mandatory and permanent employment verification systems so all employment work sites require an accurate and timely check of one's immigration status.

I would also add that I hear some of the same complaints from Arkansas employers, that there are not enough workers. There are still 50,000 Arkansans who are not working. Of the working-age population, I think, in this country, it is more like 5 million. Most of the time when employers say Americans will not do this job, they put a period at the end of that sentence when it deserves a comma followed by a clause saying "at the wage I want to pay them." And one thing we have seen over the last 2 years is that as wages go up for working-class Americans, more people are coming off the sidelines.

I want to turn, though, away from immigration. We discussed that in the first round, which is one way you can hurt blue-collar jobs by importing workers to take them. A second way is through bad trade agreements by exporting their jobs to other countries. I want to focus here in particular on China. I think one of the worst decisions in Washington in the last 20 years—and both parties are guilty of it—was first to grant China most-favored-nation status after that had been rebranded permanent normal trade relations, and then to admit them into the WTO. There were many predictions by politicians on both sides about China becoming a more liberal and democratic society and respecting its people's rights and paying its workers more and becoming a more normal, civilized nation. There is no set of predictions that has failed more terribly, I would submit, in the last 20 years than the prediction about what would happen with China.

If these jobs were not to be done in America, at least maybe they could have been done in a country like India or Vietnam that is not explicitly committed to displacing America as the world's super power. This has no doubt had terribly negative effects on the manufacturing base and blue-collar workers in this country.

Mr. Cass, I want to talk to you about that so-called China shock, as some people call it, and what we can do to reverse it and also reinvigorate the industrial base here in America and blue-collar jobs in the manufacturing sector.

Mr. CASS. Yes, thank you, and I think it is important to recognize that the trade and immigration discussions are really two sides of the same coin. You know, I agree entirely with Ms. Lee that we want to have a healthy labor market, we want workers to have power in that market, and so incredibly important is the question of who gets to be a worker in that market. Who do employers have access to to get the work done? And, historically, the answer has been the people in America. And through both our immigration and then our trade policies, specifically with Chinese, we have changed that answer to whoever in the world you can find to do it most cheaply. And in that sense, immigration and trade have very parallel effects, both of which to the detriment of American workers. And what we have seen with China in particular is a very enthusiastic choice of employers to have things made there. And what we have seen with the China shock in particular—and that happened with unprecedented speed—is just the shuttering of factories in the United States and the shifting of that production.

And I think it is important to emphasize that while politicians were entirely wrong about PNTR, this is essentially what economists said would happen. Standard economics of free trade says, well, yes, all of the manufacturing that can be done more cheaply with less skilled, oppressed workers in China, firms will move it there. The problem is that economists did not attend to the question of what would happen to the workers left behind. They either assumed that they would simply retrain for new jobs quickly or that ultimately, in fact, it does not matter what happens to workers as long as stuff gets cheaper for everybody.

And so those are the effects that we have seen, and I think, again, from both the trade and immigration lenses, focusing on this idea that constraining who employers and firms can use as their labor pool is critical to strengthening the health of the labor market and, therefore, the opportunities for American workers.

Senator COTTON. Dr. Levin, could you weigh in on the question?

Mr. LEVIN. Yeah, I certainly agree with what Mr. Cass has said, and I would add that there are other elements that enter this question when we talk about China in particular, because China also presents various kinds of national security issues where it matters where certain things are made. It matters that the United States has the ability to produce some things and not just to consume those things. And so it does seem to me that the question—even for those of us who believe in free trade as a general matter, the question has got to take specific forms in specific instances, and China presents a set of challenges that should have been thought about rather differently.

It also matters ultimately what it is that people in America do. You know, I think an economist looking at what has happened since China entered the WTO could say unemployment is lower now than it was then. And it is. But there is a difference between service work and manufacturing work, a difference in terms of its effects on communities, its effect on families, its effect on the lives of workers that just has to be taken seriously or we cannot surrender ourselves to abstract economic theory and imagine that that is all there is to social policy and public policy. There is more to it.

Senator COTTON. Ms. Lee, it looked like you wanted to respond.

Ms. LEE. I did. Thank you so much, Mr. Chairman. I would just like to say in defense of economists that not all economists drank the Kool-Aid in terms of China PNTR. I worked for the AFL–CIO during the debate, and we were fighting very hard not just about whether China would join the WTO but on what terms. And it was our view that our negotiators were putting too much emphasis on multinational corporate profits and mobility and flexibility and not enough on American jobs. And we did not assume that American workers would automatically be reemployed. Most economists were saying it was going to be fine, that we were going to have a smaller trade deficit with China and so on, and that did not happen.

But I would say that the United States does need to reorient its trade policy, particularly with respect to China, which is our most problematic and most lopsided trading relationship. We need to address the systematic and egregious unfair trade practices. I would put two or three at the top of the list for China. One is manipulation or misalignment of currency. The other is illegal subsidies that we have not done a good job addressing, even though we have tools under the WTO to do so. And the third is workers' rights. When we engage in this trade relationship with China and we do not address the fact that workers in China do not have basic human rights at the workplace, that they cannot form an independent democratic union if they want to do so, we are putting American workers and thereby American businesses that are still producing on American soil in direct competition with workers who are not free to negotiate for their fair share. And that has led to this imbalance. It is not just the size of the trade deficit with China. It is also the composition. Our bilateral trade deficit with China is in advanced technology products, it is in important areas where the Chinese government has been very strategic about addressing 5-, 10-, 15-year plans. On the other hand, the U.S. Government has not been strategic and does not have a coherent, comprehensive plan to address that or even to identify it as a problem.

So I would say it is an important issue in terms of a healthy U.S. labor market going forward. So thank you for the opportunity.

Senator COTTON. If China had allowed total unfettered access to its market for American manufactured goods over the last 30 years and totally excluded investment banks, hedge funds, and consulting firms, do you think the consensus in Washington might be different on the trade question?

Ms. LEE. Maybe.

Senator COTTON. Thank you.

Senator Smith.

Senator SMITH. Thank you, Mr. Chair.

I am interested in this conversation about the interplay between a healthy labor market and immigration and want to just agree with Senator Cortez Masto that what I hear in Minnesota is issues around the shortage of labor, especially in agriculture and food processing and seasonal work. But, Chair Cotton, you make a point, which is people say—you know, this question of nobody is available to do the work at that wage. So I would like to ask Ms. Lee, what can we do to increase wages?

Ms. LEE. Thank you. Well, there is a minimum wage bill that will be taken up by the House tomorrow, so that is an exciting——

Senator SMITH. When is the last time we raised the minimum wage?

Ms. LEE. It was 9 or 10 years ago, so this is the longest stretch we have gone without raising the minimum wage. The minimum wage now is 25 percent below where it was in real terms in 1968. This is an enormous erosion in a wealthy society, a society that is more productive, more technologically advanced than it was in 1968. We ought to be able to pay workers enough so that they can afford to feed their families and have a decent place to live. We need to fix our broken labor laws so that workers have a fair chance at coming together to be able to bargain for their fair share of the wealth that they create.

Senator SMITH. This is a question that I ask Minnesota businesses all the time. If you have trouble recruiting people to fill the jobs that you have, have you tried paying more?

Ms. LEE. Yes, as an economist, you have to say there is no such thing as a labor shortage. There are only wages that are too low.

Senator SMITH. Right.

Ms. LEE. It should be very straightforward, that if you want to attract more and better workers, do not sit there with the same low wage and scratch your head as to why people are not lining up to take those jobs. Maybe you need to just pay more and not argue for more visas or other things.

Senator SMITH. It would suggest that there is something that is not working in the labor market, that there is an imbalance of power in the labor market, which causes wages not to be stagnant while there is so much wealth in the economy.

Ms. LEE. When we are at a place where real wages for the bottom 70 percent of American workers have been stagnant for 20 or 30 years, there is clearly something broken there. Wages are so low that it is actually dysfunctional. Maybe Senator Cramer mentioned it earlier—that there is a low labor force participation rate in the economy. Raising wages, empowering workers to form unions, protecting labor standards, and making sure that labor relations are fair would actually draw people into the labor force. Wages might be so low and jobs so bad that it is rational for people not to come to work if they cannot pay for transportation and child care.

Senator SMITH. Thank you. I have another couple minutes. Would anybody else on the panel like to respond to this issue? Mr. Miller?

Mr. MILLER. I would like to, because I think those of us in the quick service franchise world are kind of stuck in the middle on this, and that is because, yes, we see a real shortage of workers. And then you ask the question, well, why don't we pay more? And we are in a margin squeeze right now. Our whole industry is in a margin squeeze, yet you see many of our franchise companies reporting record earnings per share while the local franchise owner is working harder and longer for less money than ever.

Senator SMITH. So who is squeezing the margin, Mr. Miller?

Mr. MILLER. Well, between national promotions many times—I mean, I am in California, so obviously we are not the cheapest labor market in the world. You know, consumers are—you know, overbuilding of our industry, we have too many restaurants—I mean, the pace of restaurants being built outpaces population growth. Therefore, you know, simple economics. I am a sandwich guy. I can figure these economics out. And the pie is getting cut too tight. But, you know, the franchise company makes more and more. If you build ten units, you know, instead of eight units, they get it on top-line revenue; we are getting it on bottom-line profit.

Senator SMITH. Someone is taking the money.

Mr. MILLER. Yes.

Senator SMITH. Right. Thank you.

Mr. MILLER. We are—like you say, pay more, but our business model is not allowing us to pay more at this point.

Senator SMITH. Thank you, Mr. Chair.

Senator COTTON. That buzzer you heard was votes being called on the Senate floor, so I think we are going to have to adjourn here. But I do want to thank—oh, Senator Cortez Masto has follow-up.

Senator CORTEZ MASTO. Thank you, because I do want to follow up on that conversation because this is the reason why I am introducing legislation later this month to ensure that prospective franchise owners receive accurate revenue and store closing information from the franchise corporation before they receive a guaranteed loan from the Small Business Administration. But let us elaborate on this, Mr. Miller, because what I hear from our Nevada franchisees is that—I will give you an example. Some franchise owners I have heard from tell me they are forced to sell products that they and their customers do not want, that they are charged fees for services that are not valuable to them, and they stay open longer than is profitable, and only buy products and services from approved and overpriced vendors. And I am assuming that is because that is what they are told to do or dictated to by the terms of the contract with the franchisor. Is that correct?

Mr. MILLER. That is correct.

Senator CORTEZ MASTO. And that goes to why you just talked about your margins——

Mr. MILLER. Margins, and I will give an example because it was blatantly obvious to everyone. Quizno's grew to about 5,000 units. It is now a little under 400 units. And the interesting part is it was not that they were a consumer failure. The business model failed. Quizno's took on additional debt, the corporation, to try to expand. They also owned the distribution channel. And what was happening was, as they started getting cash-flow tight, they would increase the margins on the distribution model. When they filed bankruptcy, they were actually collecting almost double the amount of revenue off of their distribution channel as they were off of royalties. They were collecting 7 percent royalties; 21 percent, there is no way they could make it in our industry. So there are ways—and when we go to disclosure, one of the big problems with disclosure is disclosure is only valid the day you get that disclosure. So if you went to go buy a Quizno's and you would see maybe, oh, they were—people talk about rebates or kickbacks in our industry, and they have to be reported. But let us say for the last 20 years a brand took 1 percent rebate from the vendors and then used that for advertising. Full transparency, I would not mind that. That is what is in the disclosure document. You buy that franchise, and what happens if next year they take 10 percent rebates? Because the contract says they can take rebates. It does not cap it. And so here you have this disclosure that for 20 years they have taken 1 percent. They raise it to 10 percent, that completely changes your business model.

Senator CORTEZ MASTO. Thank you, and thank you for—Ms. Lee, did you have a comment?

Ms. LEE. Just a quick point—I wanted to reinforce what Mr. Miller is saying. One of the things that we are seeing is a risk shift from employers to workers or to franchisees. In Mr. Miller's testimony, he talked about a lot of the ways in which there is only an upside for the franchise companies. For the franchisees, the little guys, there are so many risks and so many unfair conditions imposed. These are the same kinds of things we see in terms of the battle in California over Uber drivers, where the company has all the upside and the workers take on the risk. Workers take on the expenses of gas and upkeep and repairs on their cars, but also the risk of not enough business. The company cannot lose from that model. They have all these folks that are just circulating around, driving, and wasting their time. And so the shift from being an employer to having a bunch of independent contractors who own their own equipment and take on all the risk is one of those things that has systematically undermined worker power in the economy.

Senator CORTEZ MASTO. Thank you. And thank you to all the panelists. This was a great conversation today. Thank you.

Senator COTTON. Thank you to the witnesses. We Senators need to go vote, so this hearing is adjourned.

[Whereupon, at 11:05 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR TOM COTTON

Welcome to the Economic Policy Subcommittee hearing on this important topic of: "Economic Mobility: Is the American Dream in Crisis?" I'd like to thank the Senator Cortez Masto and the witnesses for being here, and also our Banking Committee staff for their help putting this together.

Now I'd like to introduce our terrific witnesses.

Mr. Oren Cass is a Senior Fellow at the Manhattan Institute and the author of the 2018 book, The Once and Future Worker: A Vision for the Renewal of Work in America. Mr. Cass was formerly the Domestic Policy Director of Mitt Romney's Presidential campaign in 2012.

Dr. Yuval Levin is a Resident Scholar at the American Enterprise Institute and the Founding Editor of National Affairs. Dr. Levin served as a Member of the White House Domestic Policy staff under President George W. Bush.

Mr. Ramesh Ponnuru is a Visiting Fellow at the American Enterprise Institute, a Senior Editor for National Review, and a Columnist for Bloomberg Opinion.

Ms. Thea Mei Lee is President of the Economic Policy Institute and formerly the Chief International Economist for the AFL–CIO. She has served on advisory boards for the State Department and the National Bureau of Economic Research.

Mr. Keith Miller is the founder of Franchisee Advocacy Consulting. A Subway franchisee himself since 1988, he served as Director on the North American Association of Subway Franchisees. Thank you all for coming and for your testimony. Your written testimony will be entered into the record.

We're here to discuss economic mobility and the American Dream. When economists discuss these things, they often think in terms of GDP growth and consumer prices. To exaggerate just a little, they often seem to believe that so long as the economy grows at 3 percent and Americans can afford more cheap plastic stuff from China, that America must doing great. But is that really true?

When I talk to Arkansans, I hear a different story. Most of them don't dream of extravagant wealth, much less abstract ideas like "economic growth" and "consumer surplus." They know a life of getting and spending cannot hope to fulfill ones dreams.

Instead they dream of a career that pays an honest wage so they can live in a decent neighborhood. They dream of getting married and starting a family. And ultimately, they dream of passing on this standard of living to their children—plus a little bit more. That's the American Dream I hear, according to the Arkansans that I know.

The question for today is: Is our Nation helping Americans achieve this American Dream, or are we failing them?

I have to say, I think in some important ways our Nation is failing our fellow citizens. The labyrinth of subsidies, regulations, and misguided priorities constructed by Washington does little to help the large majority of Americans who don't graduate from college; the "Silent Majority" who work with their hands and on their feet.

Our Government doesn't offer these Americans much beyond occasionally moralizing about their supposed shortcomings: "Go to college," "abandon your hometown," or "learn to code."

What they really need are more viable career paths that don't involve expensive educations. There are many good-paying, honorable jobs for people without college degrees in this country. But, how do we create more of them? How do we prepare workers so they're ready for those jobs?

There's another urgent context for today's hearing as well: our economic competition with China. For decades, Washington pursued a policy of integration with China. The architects of this policy hoped naively that enriching the Chinese Communist Party would make it more pliable and less communist. Instead, it gave China the means to challenge America around the world—all while decimating the American heartland.

If we want to remain the world's strongest economy, we'll need to marshal every citizen, every skill, every talent, at our disposal. We'll need to recover the vitality, productive abilities, and indeed patriotism that contributed to America's resounding triumphs in the past century.

If we build a more productive economy, it'll serve not only our strategic interests as a Nation, but the interests of the American people, by helping them achieve the American Dream.

I look forward to your thoughts and to my colleagues' questions.

PREPARED STATEMENT OF SENATOR CATHERINE CORTEZ MASTO

Thank you Chairman Cotton and welcome to all our witnesses here today.

I appreciate Chairman Cotton suggesting a hearing to explore barriers to economic mobility in the United States.

The Senate Banking Committee has jurisdiction over many of the most pressing issues facing Americans today—from housing, to lending, to transportation.

Today, we discuss how Congress can improve economic outcomes for children and families.

We want our children to grow up and become financially self-reliant.

We want the children of renters to be able to own their own homes if they wish.

We want children whose parents struggled to put food on the table to be able to afford a full pantry and even a few meals out every month.

We want children who survived homelessness to grow up with an income adequate to not just pay the rent but save for their children's college education and their own retirement.

We want workers retiring from one career to be able to open a small store and have it thrive.

Yet, those dreams—the American Dream—are unattainable for too many.

Parents who lack affordable bank accounts end up with financial products that can lead to a debt trap. As they struggle with bank fees, they may see their car repossessed, resulting in getting fired from their job and getting evicted from their home.

The average college senior graduates with more than $30,000 in debt, and total student debt nationwide has topped $1.5 trillion dollars.

And some college graduates cannot find jobs that pay enough to manage their crushing student loan debt. They delay starting a family, buying a home, and saving for retirement for a decade or more.

An entrepreneur buys a franchise business but finds the business never earns as much as she was promised. As she struggles to keep her store in the black, she does it all on her own—she can't afford to hire employees and pay them a living wage. That's wrong.

It is wrong that the ZIP Code where a child is born and grows up affects their future income and financial success more than that child's education, aptitude or work ethic.

It is wrong that a lack of affordable financial products prevents families from building up savings to respond to a broken arm or a broken car without a major financial crisis.

It is wrong that corporations use noncompete clauses, union busting and arbitration clauses to keep wages low and corporate profits high.

It is wrong that high housing costs, lack of affordable child care and inadequate transit restrain economic mobility for struggling families and young adults.

It is wrong that entrepreneurs who purchased a franchise—many of them immigrants, retirees and veterans—were misled by unfair contracts, deceptive financial information, and nondisparagement clauses.

We need solutions.

And we know many of them are already out there.

In their written testimonies, the witnesses have suggested significant investment in education, health, and other public services. They want to empower workers and franchise owners. They recommend tackling monopolies and corporate concentrations that drive out competition and result in lower wages for workers.

We have seen how Government can protect homeowners, small business owners and entrepreneurs from predatory and abusive practices and financial products.

I want to especially thank Mr. Keith Miller who took the red eye from California to be here today.

Mr. Miller has helped Nevada franchise owners who have seen their incomes plummet when they bought a franchise. These entrepreneurs were upper-middle class but now face foreclosure and bankruptcy in a few months or years only because they bought a franchise.

Later this month, I plan to introduce legislation to ensure prospective franchise owners receive accurate revenue and default information from the franchise corporation before the franchisee receives a guaranteed loan from the Small Business Administration. I encourage others to join my bill.

In closing, I look forward to hearing from today's witnesses.

It is my hope that today's hearing will jumpstart a discussion on the Senate Committee of Banking, Housing and Urban Affairs about how we can improve economic mobility for current and future generations.

I hope to work with my colleagues in the Senate on solutions.

Because every family in America hopes for the same thing: that their children's lives will be more stable, safer, and more prosperous than their own.

Testimony

Economic Mobility: Is the American Dream in Crisis?

Oren M. Cass
Senior Fellow, Manhattan Institute for Policy Research

Before the
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Economic Policy
United States Senate

July 17, 2019

Chairman Cotton, Ranking Member Cortez Masto, and Members of the Committee, thank you for inviting me to participate in today's hearing.[1]

"Economic Mobility: Is the American Dream in Crisis?" is on one hand a critically important topic. Policymaking must orient itself toward clear objectives, and surely the preservation and expansion of the American Dream are among the most important of those. On the other hand, is "economic mobility" what Americans dream of? Not primarily. In 2017, the Pew Research Center studied the question of how Americans define the American Dream and found that economic concerns rank low (see **Table 1**). By far, the components of life most often deemed essential to achieving the dream were "freedom of choice in how to live" and "have a good family life." Next came "retire comfortably" and "make valuable contributions to community," then "own a home" and "have a successful career." Last, and ranked essential by only one-in-nine respondents, was "become wealthy."[2]

Table 1: "Do you think each is essential, important but not essential, or not important to your own view of the American dream?"

	Essential	Important, not essential	Not important
Freedom of choice in how to live	77%	22%	1%
Have a good family life	70	28	2
Retire comfortably	60	36	3
Make valuable contributions to community	48	46	5
Own a home	43	48	9
Have a successful career	43	50	6
Become wealthy	11	49	40

Source: Pew Research Center

Another poll conducted by Pew in 2014 adds further perspective: 92 percent of Americans said that "financial stability" was more important to them than "moving up the income ladder." That share actually rose seven points from 2011 to 2014, during a period of economic recovery.[3]

Good economic outcomes are a critical prerequisite to these expressed priorities. Exercising freedom of choice in how to live becomes difficult without the capability to achieve self-sufficiency. Financial stability itself suggests a degree of labor-market success. But in general, the American people appear to have a much richer and more nuanced view of the determinants of their quality of life than do many of their leaders, who have tended to equate prosperity with growth, material living standards, and equality of opportunity on the economic ladder.

[1] Portions of this testimony are adapted from Oren Cass, *The Once and Future Worker: A Vision for the Renewal of Work in America* (New York: Encounter Books, 2018); and Oren Cass, "The Workforce-Training Grant," Manhattan Institute, July 2019.

[2] Samantha Smith, "Most Think the 'American Dream' Is Within Reach for Them," Pew Research Center, October 31, 2017.

[3] "Americans' Financial Security: Perception and Reality" (Issue Brief, Pew Charitable Trusts, Philadelphia, March 2015).

This disconnect underscores the importance of precision when discussing economic mobility and opportunity: what exactly do we mean, why do we care, and what should be our goal? My testimony today argues for a greater emphasis on providing all Americans with the genuine opportunity to build a good life rather than on the unachievable ideal of guaranteeing "equal opportunity." I then highlight our nation's misguided obsession with higher education as an area ripe for reform.

I. Mobility and Opportunity, Defined

Formally, economic mobility can refer to both *absolute* and *relative* concepts. Absolute mobility measures whether the economic conditions of similarly situated people improve from one generation to the next—for instance, how does the median American today compare to the median of twenty or fifty years ago? Are people at age 30 better off than their own parents were at the same age? Relative mobility, by contrast, measures the degree to which people land at different points within the income distribution than did their own parents—for instance, what share of children raised in poor households reaches the top quintile of earners as adults?

Most measures suggest that absolute mobility has declined in America and that the current generation has made less progress than prior ones or even fallen backward. At the end of 2016, Harvard professor Raj Chetty released a landmark study that used millions of tax records to compare parents' and children's earnings. For children born in 1950, 79 percent had higher earnings by age thirty than their parents had at the same age. But for those born in 1980, only 50 percent could say the same.[4] Looking ahead to the next generation, only 37 percent of Americans expect that "when children today in our country grow up they will be better off financially than their parents."[5]

Both measuring and interpreting relative mobility is more complex. While everyone can benefit from high levels of absolute mobility, relative mobility is a zero-sum game: when some people rise within the income distribution, others must fall. Indeed, a high level of relative mobility may not even indicate a prospering society—economic collapse could have a shake-the-snowglobe effect that disconnects people's relative socioeconomic status from that of their parents, but it would hardly be cause for celebration. Still, the metric remains important because of its implications for *fairness* and *opportunity*. A society with *no* relative mobility would be one in which someone's station at birth dictated his economic trajectory regardless of his own aptitudes and efforts. High relative mobility suggests that opportunity is widely accessible.

[4] Raj Chetty et al., "The Fading American Dream: Trends in Absolute Income Mobility since 1940" (Working Paper 22910, National Bureau of Economic Research, Cambridge, Mass., December 2016).

[5] Bruce Stokes, Global Publics More Upbeat about the Economy: But Many Are Pessimistic about Children's Future (Washington, D.C.: Pew Research Center, June 2017).

American politics often starts from the presumption that our goal is "equal opportunity" defined as "equality of life chances"—that where a child starts should have no bearing on where he ends up and that everyone should have an equal chance of arriving at any destination.[6] That is plainly impossible in a world in which individuals possess different innate characteristics and grow up in different environments. Perhaps it could be reached by replacing unique individuals with generic clones and diverse family environments with state-run children's homes. Most people would agree that this is not desirable.

A more pragmatic vision of equal opportunity entails removing any *public impediments* that obstruct individuals in pursuing their goals. Unfortunately, that may not get us as far as we would like. Consider the findings of the Brookings Institution's Richard Reeves, who used data from more than five thousand Americans born mostly in the 1980s and 1990s to compare the income quintile in which they were born to the income quintile they later reached. So, for instance, of those born into households with income in the bottom 20 percent of all American households, how many found themselves in the bottom 20 percent as adults?

Family structure dictated opportunity. For someone born in the bottom quintile to a married mother and raised by both parents, the odds of reaching the top quintile were higher (19 percent) than remaining in the bottom quintile (17 percent). Indeed, those children faced almost perfectly equal chances of landing anywhere as adults (between 17 percent and 23 percent in each of the five quintiles). Public impediments appeared to exert little influence. But for someone born in the bottom quintile to a never-married mother, the odds of rising to the top quintile (5 percent) were one-tenth those of remaining in the bottom quintile (50 percent). The private impediment was almost insurmountable.[7]

In the face of dynamics like these, guaranteeing "equal opportunity" would require implementation of public programs capable of counteracting all of life's disadvantages. American policymakers have come to see education as the panacea capable of accomplishing just that, and so have embarked upon the quixotic quest of "college for all." This approach has been a mistake whose primary victims are precisely those it is intended to help—people who remain unlikely to emerge successfully from a high-school-to-college-to-career pipeline yet are offered no meaningful alternative (as discussed below in **Part II**). The sad irony is that, in our effort to deliver "equal opportunity," we have built an education system that more resembles an impediment to opportunity. If the aspirations of the American people—the American Dream—in

[6] David Azerrad, "How Equal Should Opportunities Be?," *National Affairs*, Summer 2016.

[7] Richard V. Reeves, "Saving Horatio Alger: Equality, Opportunity and the American Dream" (Brookings Essay, Brookings Institution, Washington, D.C., August 20, 2014).

fact *required* an equalization of life chances then perhaps it would be appropriate to continue tilting at windmills in hopes of somehow emerging victorious. Fortunately, they do not.

Rather than measure the American Dream in terms of economic mobility and the number of rags-to-riches stories featured in the news, policymakers should focus on ensuring that every American has access to some minimum, absolute level of opportunity to achieve self-sufficiency, support a family, contribute to a community, and then provide to his children even greater opportunity. Historically, someone who earned the basic level of education widely attainable within society, worked full time, and formed a stable family could reasonably expect to achieve all these things. And he could achieve them either by setting off for a new city or staying right near home.

Measured against such objectives, America faces very serious challenges. Consider how the median income of a man with a high school degree compares to the poverty line for a family of four. In 1970, he could support a family at more than double the poverty line. In 2016, he cleared that threshold by less than 40 percent. In dollar terms, that represents a loss of roughly \$20,000 in 2016 earnings; a median of \$33,500 instead of \$54,200.[8] The U.S. Census Bureau reports that, between 1975 and 2016, the share of men aged twenty-five to thirty-four earning less than \$30,000 per year rose from 25 to 41 percent.[9]

Figures like these give us the best indication of how the American Dream is doing in economic terms, and they should worry us deeply. If decades of extraordinary economic growth and technological progress have left them trending downward, a serious reexamination is in order.

II. Implications for Education

U.S. public policy relies almost exclusively on college to prepare young men and women for productive employment. Within the education system, high schools operate primarily as college-prep academies, and waves of reform have focused ever more intensively on "college readiness." Federal and state subsidies to higher education total more than \$150 billion annually.[10] The federal government today spends only \$1 billion annually on Career and Technical Education (CTE), and the funds devoted to CTE have been declining steadily in real terms. Since 1990, the share of high school students

[8] "Historical Income Tables: People," U.S. Census Bureau, tables P-16 and P-17; "Poverty Thresholds," U.S. Census Bureau.

[9] Jonathan Vespa, *The Changing Economics and Demographics of Young Adulthood: 1975–2016* (Washington, D.C.: U.S. Census Bureau, April 2017).

[10] Oren Cass, "How the Other Half Learns," Manhattan Institute, August 2018. This total includes state university systems and state tuition aid, federal Pell Grants and loan subsidies, and tax benefits.

earning CTE credit, the share of credit-earners qualifying as CTE "concentrators," and the average number of CTE credits earned per student have all declined as well.[11]

This overwhelming emphasis on college as the path to productive employment is not working. Only one-third of Americans earn a bachelor's degree by age 25, and that figure has changed little in the past two generations;[12] most Americans still do not attain even a community-college degree.[13] Even among recent college graduates, 41% hold jobs that do not require a degree.[14] All told, fewer than one in five Americans move smoothly from high school to college to career.[15]

One reason for these meager results is that colleges themselves are not designed to play the role of career preparation for the masses. By overwhelming margins, Americans' top priority for higher education is employment opportunity,[16] but that's not the role that institutions see for themselves. As Harvard University's Claudia Goldin and Lawrence Katz have observed, "The business of colleges and universities is the creation and diffusion of knowledge."[17] In a 2017 survey by Gallup of more than 700 college and university presidents, only 1% strongly agreed with the statement that "most Americans have an accurate view of the purpose of higher education"; four times as many disagreed as agreed.[18] Nor do most educators have up-to-date experience with relevant technical skills or in industries outside the field of education.

Appropriate pathways for most young people preparing to enter the workforce would focus on technical training coupled with time on the job. This is the approach taken by virtually every developed economy besides the United States. For most developed countries, according to a report by the Organisation for Economic Co-operation and Development (OECD), 40%–70% of high school students are enrolled in career pathways that emphasize technical training, often with a significant on-the-job component. The U.S. is excluded from the analysis because of "the rather different approach to vocational education and training in US high schools."[19] Beyond the

---

[11] U.S. Department of Education, "National Assessment of Career and Technical Education: Final Report to Congress," September 2014.

[12] David J. Deming, "Increasing College Completion with a Federal Higher Education Matching Grant," Brookings Institution, Hamilton Project, April 2017.

[13] National Center for Education Statistics, Digest of Education Statistics 2018, February 2019, table 104.30.

[14] Federal Reserve Bank of New York, The Labor Market for Recent College Graduates, "Underemployment Rates for College Graduates," May 2019.

[15] Cass, "How the Other Half Learns."

[16] Rachel Fishman, "Deciding to Go to College," New America Foundation, May 2015.

[17] Claudia Goldin and Lawrence F. Katz, "The Shaping of Higher Education: The Formative Years in the United States, 1890 to 1940," *Journal of Economic Perspectives* 13, no. 1 (Winter 1999): 38.

[18] Scott Jaschik and Doug Lederman, eds., "2017 Survey of College and University Presidents," Inside Higher Ed and Gallup, 2017.

[19] *Learning for Jobs* (Paris: OECD, 2010).

education system, the U.S. focuses little public investment on worker training: less than 0.1% and declining as a share of Gross Domestic Product; among the lowest levels in the OECD; and an order of magnitude less than many developed economies.[20]

Effectively reforming the American system requires the implementation of tracking: offering dramatically different programs of secondary education depending on whether the student will proceed next to college or directly to a career. Unfortunately, this also explains why the American system has gone so far astray and reform will be so challenging. Americans have long resisted tracking.

In 1892, Harvard University president Charles W. Eliot exclaimed, "I refuse to believe that the American public intends to have its children sorted before their teens into clerks, watchmakers, lithographers, . . . and so forth, and treated differently in their schools according to their prophecies of their appropriate life careers. Who are we to make these prophecies?"[21] When the nation pioneered universal secondary education in the early twentieth century, its "comprehensive high schools" emphasized a broad education in the liberal arts.[22] During the 1960s and 1970s, in keeping with so many other areas in which idealism trumped practicality at the expense of the purported beneficiaries, the notion of tracking was squelched entirely.[23]

This particular bout of American exceptionalism is a mistake. What sense does it make to treat the vast majority of high schoolers as if they were prospective college graduates when they are not, to pretend that the sudden divergence of outcomes after high school graduation did not in fact begin long before? Indeed, the best way to understand the American system is not as trackless but rather as committed to a single track tailored toward those most likely to succeed anyway.

One common objection to tracking is that a career track will be disproportionately populated by students from disadvantaged backgrounds. But this is a description of society and an implicit condemnation of the current system, not a plausible criticism of tracking. After all, students best suited to a career track are precisely those least well served by its absence and experiencing the worst outcomes today. A tracked system could offer them a better chance at economic success, increasing in turn the odds that their own kids land on the college track a generation later. It will speed social progress and improve countless lives along the way.

[20] "Public Spending on Labour Markets: Training (2000–2016)," OECD Data, 2019; see also "Labor Market Training Expenditures as Percent of GDP in OECD Countries, 2011," Brookings Institution, Hamilton Project, June 2014; "Artificial Intelligence, Automation, and the Economy," Executive Office of the President, December 2016.

[21] Sandra Salmans, "The Tracking Controversy," *New York Times*, April 10, 1988.

[22] Paul Beston, "When High Schools Shaped America's Destiny," *City Journal*, 2017.

[23] Tom Loveless, *How Well Are American Students Learning?* (Washington, D.C.: Brookings Institution, March 2013).

A tracked system also will unavoidably place some students on a career track who might have done well in college. But the career track is not a death sentence. It can lead in many cases to a more fulfilling (and even more remunerative) career than might the college track, especially for its most talented students. And individuals would have opportunities to shift tracks both during their education and much later; as the *New York Times* notes, "it is not uncommon to find executives in Europe who got their start in apprenticeships."[24] No public education system will serve every student well, but the share finding themselves mismatched will be far lower if programs at least try to meet the needs of the majority.

Society must choose between proceeding with a charade and acknowledging honestly the limitations it faces. Pretending against all evidence that every student should prepare for college sustains the fiction that government programs can compensate for various background disadvantages and thus deliver "equal opportunity," defined as equality of life chances. Pushing every student in that direction yields the occasional Horatio Alger story, which warms the heart and stands for the proposition that the same could happen to anyone, even though its rarity in fact underscores the opposite. The approach is most useful to those least affected by it, who benefit from innate and environmental advantages, who can flourish in college, and who can now justify a broad array of economic policies that further benefit themselves by claiming that everyone else can follow their path too. It is most harmful to those already disadvantaged, who must now navigate a system that has proven repeatedly its inability to meet their needs.

The Workforce-Training Grant

The federal government should take aggressive policy action to facilitate the creation of attractive noncollege pathways and channel investment toward people traveling along them. Effective reforms will recognize that, while society has a strong interest in supporting young people as they move from high school toward adulthood and the work force, universities are not necessarily the institutions best suited to provide that support. In many cases, the best providers will be employers. Here I propose a specific policy, the Workforce-Training Grant, which would place employers on equal footing with universities by creating an open-ended government stipend attached to eligible private-sector workers and payable to any employer placing a worker in a program of combined on-the-job experience and formal skill development.

The grant should be structured as a per-worker payment that employers receive for employing someone under the conditions defined as workforce training. Other programs exist that provide tax credits for the employment of particular classes of

[24] Jeffrey J. Selingo, "Blue Collar Redefined," *New York Times*, February 5, 2017.

workers (e.g., the Work Opportunity Tax Credit[25] and the proposed ELEVATE Act[26]). But these programs typically target narrow groups with specific formulas. The better approach is to define broadly the circumstances of someone who is employed while in training and designate that person as a "trainee," essentially the equivalent of a "student" as we recognize someone enrolled in college.

For example: a trainee might be defined as any person who is employed at least 15 hours per week and also engaged in a certified training program for at least 15 hours per week – regardless of the trainee's personal characteristics and regardless of where the training program is provided. This would place employers in control of offering the jobs and related training, while leaving workers in control of what program/employment they want to accept. Just like federal subsidies for college, the funding is attached to the trainee but flows through the provider (in this case, provider of employment).

An employer would receive a $10,000 per-year payment (prorated) for employing a trainee, disbursed directly to the employer, just as traditional tuition loans and grants are paid directly to schools. Employers would have to initially register employees as program participants, with verification from employees themselves of their trainee status, after which that status would be tied directly to the tax identification data through which payroll and other taxes are reported and withheld each pay period. As a condition of program participation, employers could be required to participate in a reporting program that tracks the employment status and long-term earnings of employees who begin as trainees.

Employers could potentially even employ trainees for "free" but would want to do so only if they saw the trainees as adding some value to the business. (The grant would be sufficient to pay the worker $13 per hour for 15 hours per week, though the employer would still need to provide a training program or pay the cost of attendance at a third-party program.) An employer could hire trainees and receive the grant only if their employment/training offer were the one most attractive to the trainee – if some other firm wanted to offer better training, or a higher wage, or a more attractive career path, the trainee could go there instead.

In many cases, community colleges might provide the site for training. Critically, though, colleges could no longer attract public funding only by enrolling a student – rather, their customers would now also include employers, and their success would depend on offering programs that appeal to employers' needs. The employer would likewise have a greater incentive to engage with the community college in designing

---

[25] "Work Opportunity Tax Credit," Internal Revenue Service, April 2019.

[26] "Wyden and Davis Introduce Legislation to Bring More Americans into the Workforce, Reduce Barriers to Employment," U.S. Senate Committee on Finance, news release, January 15, 2019.

a relevant and integrated program of study. In other cases, employers might operate training programs themselves or through industry associations or union partnerships.

A grant of this nature would scale gradually, as more programs gain certification. It also lends itself to initial pilots, particularly states or metropolitan areas, and potentially with caps on total enrollment. Opportunity Zones, which have already been identified by states as areas of high need and which, in many cases, have leaders actively seeking opportunities to build public-private partnerships that can attract and take advantage of new investment, might make particularly attractive targets for initial pilots. In June 2019, the U.S. Department of Labor proposed a positive step: a rule to allow entities like trade associations, unions, and colleges to define the parameters of industry-recognized apprenticeships that would be eligible for state and federal funding.[27]

Funding for the Workforce-Training Grant should be redirected from within the existing $150 billion spent by federal and state governments on higher education each year. The allocation should shift gradually and predictably: if half this total were shifted over 10 years (roughly a $7 billion cut to college and a $7 billion increase to noncollege each year), colleges and their students would have time to adjust while states, districts, community colleges, and employers would have to plan for standing up alternatives. While the federal government can shift only a portion of higher-education funding itself, states should be allowed to supplement the Workforce-Training Grant's value with their own funding.

Both the new funding for employers and the transfer of funding from the higher-education system are necessary for a more effective system. As noted, community colleges may ultimately play an active role in this new system, but their attention must turn from enrolling students directly toward partnering with employers. One source of funding will need to decline alongside the other's increase if a significant change in behavior is to occur.

Conclusion

A rebalancing is in order. Shifting funding from colleges and universities to employers may appear unappealing at first, but it is best understood as a reallocation from one training provider to another. All are entities that might hypothetically equip less educated workers with valuable skills that will accrue to their own benefit in the form of higher wages. None will do so for free. Of the providers, available evidence suggests that the latter (employers) can do a better job than the former (colleges); to pay only the former is backward in principle and has yielded poor outcomes in practice.

Thank you again for the opportunity to testify on this important topic.

[27] Eric Morath, "Trump Administration Proposes New Type of Apprenticeship," *Wall Street Journal*, June 24, 2019.

PREPARED STATEMENT OF YUVAL LEVIN, PH.D.

DIRECTOR OF SOCIAL, CULTURAL, AND CONSTITUTIONAL STUDIES
THE AMERICAN ENTERPRISE INSTITUTE AND NATIONAL AFFAIRS

JULY 17, 2019

Chairman Cotton, Ranking Member Cortez Masto, and Members of the Committee: Thank you for the opportunity to testify today.

It is very encouraging to see this Subcommittee take up the crucial question of economic mobility, and seek to understand it from a variety of angles and perspectives.

We Americans have always prided ourselves on the extraordinary degree of mobility this country has made possible for its citizens—the idea that, with hard work and a little luck, an immigrant or a child of poor parents can start out with nothing and end up successful and rich. We still believe this about ourselves. International comparisons of public opinion find that Americans express far greater confidence than citizens of other developed nations that hard work is rewarded and that everyone has a real chance to rise out of poverty. But by many measures, the United States actually does not stand out among advanced economies in terms of economic mobility, and has not for decades.

At some level, we surely sense this even if we do not know all the facts and figures. There is a divergence between what many Americans want to believe about our country and its promise and what we know to be true about the circumstances and pressures too many Americans now face. Americans at the bottom of the income scale do not have enough opportunities to move up, many in the middle feel stuck, younger workers are having trouble getting started, and Americans in general seem less inclined to follow after opportunities. These various challenges are all distinct, but they all describe forms of immobility.

In what follows I will offer a brief overview of the state of mobility in our economy and a few thoughts about potential policy responses.

Economic mobility is ultimately about improved living standards over time. It is therefore a measure of material progress, and of whether our economy is allowing people to better their conditions, which must after all be its primary purpose.

Mobility is notoriously difficult to measure, in no small part because even agreeing on its basic meaning is a challenge. But to keep things relatively simple for our purposes, we can begin to understand the state of economic mobility in America by breaking it down into two key components: relative mobility and absolute mobility.

Relative mobility refers to a person's economic status in relation to the Nation as a whole. Economists often describe it in terms of moving up the income quintiles, and the rest of us tend to think of it in the form of rags-to-riches stories. Can someone born in poverty today rise into the middle class and beyond it? Does the child of a middle class family stand a reasonable chance of ending up wealthy? Or are people destined to end up roughly where they start? The available evidence suggests that in terms of relative mobility we are now lagging behind Canada and much of northern Europe. Economist Markus Jantti and his team have found that over the past generation about 25 percent of Danish men who were born in the bottom 20 percent remained in that lowest quintile as adults, compared with 42 percent of American men. Some economists have questioned the methodology behind this finding and suggest mobility looks rather similar across the developed world. But no one argues that Americans are at this point uniquely mobile. At best we are on par with Europeans and Canadians.

And this is not because relative mobility has declined in America in the 21st century. Although you would not know it from some of our political debates, the data suggest that our national level of relative mobility has been remarkably stable—and remarkably low—for at least the last five decades. A child born to parents living in poverty at any point since the mid–1960s has had only about a 30 percent chance of ever making it into the middle class, and about a 5 percent chance of ending up in the highest fifth of income earners. Rags to riches stories, even rags to comfort stories, are awfully rare. And this has not changed much in living memory.

It is far too difficult to rise out of poverty in America, and it was so even throughout what we have thought of as America's postwar economic golden age. This problem has not gotten markedly worse (or better) as inequality has grown, and it has not improved or worsened with rising or falling growth, or tax rates, or spending levels. Neither party's economic prescriptions seem likely to change it much. It will require some new thinking.

The story of absolute mobility, meanwhile, is more complex and suggests some significant problems of relatively recent vintage. Absolute mobility involves changes in people's living standards not relative to society as a whole but relative to their own past or to the prior generation. Are you better off than you were 10 years ago? Are you wealthier than your parents were at your age?

By this measure, America looks rather good over the long run but rather bad over a shorter run and the difference is one major reason why mobility should be a priority for us. Data from the Pew Economic Mobility Project show that the vast majority of Americans, about 84 percent, now have higher incomes than their parents did at their ages—adjusted for both inflation and family size. Such intergenerational absolute mobility is actually highest among the poor: fully 93 percent of Americans in the lowest fifth of earners have higher incomes and greater purchasing power than their parents did at their ages, compared to 70 percent of Americans in the top fifth. Overall American living standards have risen over time, and this has lifted essentially everyone's living standards some, even if it has not done much to change people's relative positions in society.

But the significance of this good news is limited in two ways that will help us to clarify the mobility challenge as policymakers must now confront it. First, strong absolute mobility amid weak relative mobility means that people are more comfortable where they are in life, but that they are not moving ahead in terms of skills or status. The mother working long days behind a restaurant counter in the hope that her children have better opportunities than she did would not be satisfied to hear that her children will be a little better paid for working behind that same counter all their lives.

Second, and perhaps most important, absolute mobility has declined significantly in the last two decades, so that while most Americans are doing better than their parents did at the same age they are often not doing better than similarly situated families (and maybe even their own families) were doing 20 years ago. This is the most pressing way in which many Americans are feeling the sting of immobility these days—as stagnant wages create the sense that they're running in place.

The simplest way to illustrate this trend is to consider the median family. Adjusted for inflation and expressed in 2017 dollars, the median American household's income was $60,062 in 1999 and $61,372 in 2017, according to most recent available data from the Census Bureau. In other words, the purchasing power of the median family has barely budged over the course of the last two decades.

The average household is a little smaller than it was two decades ago, but even adjusted for family size the median income today is essentially where it was in the late 90s. This is in part the effect of the severe 2008–09 recession, which reduced household incomes sharply for a time, but it is largely a result of the fact that incomes have simply not been growing quickly, even in good times, especially since the beginning of this century. The last 2 years have seen meaningful improvements, and these should not be underestimated, but neither should they be overstated. Mobility remains a serious concern, and would become all the more of a problem if the economy slows.

That last point suggests, of course, that robust economic growth is an essential precondition for robust economic mobility. This is doubtlessly true. But although growth is necessary for mobility, it is not sufficient. A mobility agenda must begin with growth, but cannot end with it—and growth should not be pursued at the expense of other necessary preconditions for mobility.

What other obstacles to mobility do policymakers need to be aware of, then? I would like to focus here on two sets of obstacles in particular. I emphasize them not because they are the only barriers to much-improved economic mobility but because I think they are barriers we too often tend to overlook, and so would benefit from greater attention and—up to a point—might also benefit from some policy responses.

The first of these is the rising cost of living for working families. It may seem strange to raise alarms on this front, since inflation has been remarkably low for more than three decades in America. But while this is true of general inflation, household costs have actually risen dramatically in three areas of particular importance to economic mobility. We might call them "the three H's": health care, housing, and higher education.

These three areas are of enormous importance to American families in the working-class and middle-class who are striving to improve their living standards. Health care and housing are often essentially unavoidable expenses, while higher education is among the most effective means of securing a middle-class lifestyle for the rising generation. And yet in all three areas we have seen prices run far ahead of value for decades.

In all three areas, too, public policy has played a major role in that increase in costs by simultaneously restricting supply and subsidizing demand. Subsidizing demand while restricting supply has predictable consequences: It increases prices, and therefore costs.

In health care, the supply restrictions have especially (though by no means exclusively) had to do with the regulation of health insurance in ways that have restricted options and competition and so have closed off potential avenues for lowering costs. The subsidization of demand, meanwhile, has consisted of the exceedingly generous tax subsidy for employer-provided insurance, the enormous growth of Medicaid, and new forms of subsidy in the individual market through Obamacare as well as new subsidies for prescription drugs.

In housing, we have seen local, State, and Federal policies interact in ways that in many places have restricted supply through tighter zoning while subsidizing demand through tax benefits, pseudo-governmental home-loan subsidies, and various kinds of first-time-buyer benefits. Obviously there was a huge crash in this market a decade ago, but the basic pattern didn't change in the wake of that crash.

In higher education, the restriction of supply happens especially through the overly narrow accreditation process (which is a function of public policy combined with politically enabled incumbent control of the process) and subsidization of demand has happened especially through student loans and assorted tax and other benefits.

Each of these policies is plausibly defensible in itself. And even the combination of restricting supply and subsidizing demand can be defended: If the government is going to provide a subsidy for something, it needs to have some definition of that something so that the money is used for its intended purpose, and that definition is inherently going to constrict and regulate the subsidized good. But the sum of all this has been a lot of inflation in three areas that are crucial to the lives of vast swaths of our society.

A cost-of-living agenda that tried to counteract this tendency should have a lot of appeal if our politics ever gets back to thinking in terms of solving problems people face rather than just revving up outrage. There are steps to be taken on both the supply and the demand sides of each of these sectors of the economy, though political pressures will surely make addressing the supply restrictions more attractive than reducing subsidies for demand. That means opening up more options in health care and higher education through Federal policy changes (like broadening the definition of qualified health insurance and allowing greater experimentation in the accreditation of higher education and the uses of student aid). In housing, the politics of any changes on both the supply and demand sides would be exceedingly painful, particularly because the subsidization of demand generally happens at the Federal level while the restriction of supply is largely local. But that doesn't make such reforms any less important.

Rising living costs—paying more and more without getting more and more—naturally obstruct economic mobility. And they are among the obstacles to mobility for which public policy is most at fault, and could do the most to overcome.

If cost-of-living pressures are among the barriers to mobility that might prove most amenable to public-policy responses, the second set of barriers I'd like to emphasize may well be the least amenable: Simply put, among the most significant obstacles to economic mobility in contemporary America is the breakdown of the capacity of many Americans to amass social capital.

Social capital describes the resources at our disposal to enable effective cooperation—the skills, habits, networks, arrangements, grooves, and channels that make it possible for our society to hold together and for its members to benefit from it. It is absolutely vital to economic mobility, and to the health of our society more broadly. Such capital is amassed within institutions, as the result of the kind of connections we make and formation we receive in the family, the community, the church, the school, the union, the workplace, the market economy, politics, and other arenas of mutual action.

The concept of social capital offers a particularly helpful lens through which to better understand obstacles to mobility and opportunity in America because it offers us the promise of overcoming the familiar partisan division between focusing on money and focusing on culture.

The fact is that our country has become deeply divided and fragmented in ways that create some particularly pernicious and complicated obstacles for Americans trying to rise out of poverty. And our political system has sought to pin the blame for this phenomenon somewhere without fully acknowledging its character. The left tends to see economic inequality as the root of all other forms of social fracturing, and argues therefore that a policy of more aggressive redistribution would not only help ease income inequality but also mitigate the political power of the wealthy, strengthen poor communities and families, and create more opportunities for all. An emphasis on cultural problems like family breakdown, many progressives now suggest, is a distraction from these real causes—if not an attempt to blame the victims and opportunistically advance an oppressive cultural agenda that can only further burden the most disadvantaged.

The right sees cultural disintegration—marked especially by the breakdown of family and community—as the source of the persistence of entrenched poverty in America. Conservatives therefore argue that social policy must focus on family and community, and worry that the Left's misguided efforts to address entrenched poverty through greater economic redistribution can only make things worse by hampering the economy, distorting the personal choices of the disadvantaged with perverse incentives, and exacerbating dependency.

In an effort to avoid the rather obvious conclusion that cultural and economic factors are inseparable, progressives and conservatives thus tend to exaggerate the implications of their favored explanations. They predict that either growing inequality or increasing family and cultural breakdown, respectively, will turn out to be unsustainable, and so will lead to a cataclysm, or a rip in the social fabric that will force a great reckoning.

But things are likely both better and worse than that: Both growing inequality and increasing social breakdown may well be sustainable, but may not be compatible with human flourishing. We are not headed for a cataclysm, but we are stuck in a rut, and getting out of it will require understanding it. No moment of change will be forced upon us, so if we are to revive the fortunes of the least among us, we will need to act.

It is precisely mobility that is imperiled when people are denied the means to amass greater social capital. Without robust social capital, the material benefits provided by the welfare state could never be enough to enable disadvantaged Americans to rise. Without robust social capital, no amount of moralizing about discipline and responsibility could make a difference in the lives of broken families and communities. Social capital is what makes it possible for help to help.

And the liberalization of our society—both moral and economic—has undermined our capacity to sustain and replenish social capital. That liberalization has advanced under a banner of individualism, seeking to liberate each of us from constricting moral constraints and from oppressive regulation but in the process often also unmooring us from relationships of mutual obligation. And as it has advanced, it has also robbed us of mutual trust, which is an essential ingredient in the development and retention of social capital.

Social capital is built up slowly and exhausted slowly. It is built by long, arduous work constructing relationships, establishing institutions, cultivating norms, shaping expectations, and developing mutual trust. Decline is often slow as well. We can burn this capital for a long time while taking it for granted. But we have lived through a very long decline in social capital in recent decades, and its effects are being visited upon us now—and especially upon the most vulnerable among us.

The steps we incline instinctively to take in response can make the problem worse. The expansion of welfare programs that substitute for thick social networks with a check and the acceleration of efforts to liberate the economy from socially imposed restraints for the sake of greater growth that might help everyone both tend to exacerbate the pattern by which the mediating layers of our national life are emptied out. Those layers, between the individual and the national state, are where social capital is built up and put to use. And a replenishment of social capital, a recovery of the capacity to make use of opportunities and to endure setbacks, will require a revitalization of those middle spaces.

This is a cause toward which our national politics is not now naturally disposed. Instead, we incline to a politics that answers the problems created by an excessive individualism by further empowering the national government. It is important to see that this inclination is likely a symptom of the problem we are in need of solving.

Radical individualism involves the corrosion of people's sense of themselves as defined by a variety of strong affiliations and unchosen bonds and its replacement by a sense that all connections are matters of individual choice and preference. It breaks up clusters of people into isolated units. Politically, such individualism tends to weaken mediating power centers that stand between the individual and the Nation as a whole—from families to local communities (including local governments), schools, religious institutions, fraternal bodies, civil-society organizations, labor groups, and the small- and medium-sized businesses that comprise much of the private economy. In their place, it strengthens individuals on the one hand and a central government on the other, since such a government is most able to treat individuals equally by treating them all impersonally. For this reason, a hyper-individualist culture is likely to be governed by a hypercentralized government, and each is likely to exacerbate the worst inclinations of the other.

Some of the most distinctive problems of our era—the detachment from family, work, faith, and community, and the persistent patterns of bifurcated concentration throughout the American experience—are in important respects functions of a view of society as consisting only of individuals and a state, and are particularly difficult for a nation that often understands itself that way to address.

The problems we confront therefore call for solutions that somehow reinvigorate the middle layers of society, and resuscitate our mediating institutions. Those institutions may be the ones most capable of addressing the characteristic problems of our diffusing society—and the isolation and alienation that are such prominent symptoms of so many of those problems—without requiring the kind of wholesale national reconsolidation and re-centralization that simply aren't plausible now. They might better allow us to pursue diversity without atomism, profusion without isolation, and a great variety of ways of life without estrangement from the sources of human flourishing.

This would seem to make *subsidiarity*—the entrusting of power and authority to the lowest and least centralized institutions capable of using them well—a key to addressing some of the most stubborn obstacles to mobility in American life. Beyond the familiar policy applications of this kind of approach—in school choice, say, or in some conservative approaches to health care reform—there are ways that forms of decentralization could be of some use in taking on some of the distinct problems of this particular time. It could help, at least at the margins but maybe also near the core, to combat wage stagnation and the loss of working class jobs for instance by enabling experimentation not only with welfare and wage supports but with different forms of labor law and worker organizing and by encouraging competition in higher education and skills training that can create new opportunities.

It could help us meet the challenge of better enabling economic mobility, as well, by allowing for experimentation with various approaches to assisting Americans in need. Experimentation, after all, is what you do when you do not know the answer. And it is hard to deny that when it comes to our most profound socioeconomic problems in America, we do not have a reliable formula for effective help. The challenge facing welfare reformers is daunting: They have to find ways to help people who lack not only money but often also stable families, functional communities, and decent schools. They have to encourage work and responsibility while offering aid, and they often have to help people break bad habits or confront addiction or abuse while also respecting their dignity and independence. This can't be done by a government check. Welfare often works best when it is accompanied by advice, by obligations, and by evident compassion at a personal level. Using public resources to let different institutions—from State social agencies to local civic groups to churches and nonprofits—try different ways of meeting this challenge in different circumstances is what we need to do when solutions are not clear, and when it isn't clear that any one solution will suffice in different circumstances. That kind of policy logic, the logic of subsidiarity, would serve us well in many arenas.

Needless to say, neither an emphasis on restraining increases in the cost of living nor an emphasis on empowering mediating institutions offers a simple recipe for greater economic mobility in America. But these are both areas that require greater attention. Seeing them more clearly would help us better understand the broader challenge of mobility. And it is right that this broader challenge should be front and center in our economic thinking.

There is more to political life than economics. But prosperity matters, and mobility is the right way to think about what prosperity means. Americans have often understood our national Government in particular to be rightly devoted to that cause.

In a message to Congress on the Fourth of July, 1861, amid the painful early setbacks of the Civil War, Abraham Lincoln sought to articulate what made the struggle worthwhile. When it came to describing what we valued in our Government, Lincoln said this:

> On the side of the Union it is a struggle for maintaining in the world that form and substance of Government whose leading object is to elevate the condition of men—to lift artificial weights from all shoulders, to clear the paths of laudable pursuit for all, to afford all an unfettered start and a fair

> chance, in the race of life. Yielding to partial and temporary departures from necessity, this is the leading object of the Government for whose existence we contend.

America has often been gloriously successful in advancing that cause, but it has been notably less so in recent decades. We have ignored that fact for too long. I commend this subcommittee for turning its attention to this challenge, and I thank you for the opportunity to testify.

PREPARED STATEMENT OF RAMESH PONNURU

VISITING FELLOW, THE AMERICAN ENTERPRISE INSTITUTE

JULY 17, 2019

Chairman Cotton, Ranking Member Cortez Masto, and distinguished Members of the Economic Policy Subcommittee of the Senate Committee on Banking, thank you for convening this hearing on "Economic Mobility: Is the American Dream in Crisis?" I am a visiting fellow at the American Enterprise Institute, a fellow at the National Review Institute, a senior editor at *National Review,* and a columnist for Bloomberg Opinion. This testimony reflects my own views and not those of any organization with which I am affiliated. It is an honor to be testifying before you.

Our topic today, economic mobility, has been central to America's self-conception and so it is fitting that legislators should examine its condition today and what can be done to improve it. While we rightly prize relative mobility—the chance to move over the course of a lifetime from the poorest to the richest segment of society, which implies the chance to move in the opposite direction—our main concern is and should be absolute mobility. We want and should want the bulk of our population to be able to perform rewarding work, to have the wherewithal to raise a family, and to enjoy rising living standards over time.

There is a widespread sense that this kind of economic progress is a thing of the past. Today I wish to make four main points about economic mobility.

Our recent record on mobility has been poor.

There has been less mobility in recent decades—but it is important to get the timeline correct in order to draw the right lessons from it.

It is often claimed, for example, that the average wage, adjusted for inflation, has fallen over the last 50 years. The Pew Research Center suggests that this figure peaked in 1973.[1] But widely repeated claims of this nature turn out, thankfully, to be misleading, for two main reasons.

First, wage figures ignore nonwage compensation, which has been a rising share of compensation over time.[2] While it may be argued that government policies should change in ways that would encourage a shift in that mix back toward wage compensation, that's a different question from the one we would face if total compensation had been stagnant or falling for more than four decades.

Second, the estimate of falling wage compensation is itself based on a faulty method of adjusting for inflation. Pew, for example, uses the Consumer Price Index—and specifically a measure called CPI—U. It overestimated housing inflation before 1983. Before 1999, it did not account for the way consumers blunt the impact of inflation by changing their behavior, and it still does not fully account for it. Using the PCE deflator to estimate inflation over time avoids these problems.[3] Over time the difference is large: It turns out that the average wage rose 21 percent from 1973 through 2018 rather than falling.[4] Average compensation must have risen even more. One could certainly wish that the increase had been even larger, but this is not a picture of decline or stagnation.

Median family income over this stretch of decades has also grown. The family in the middle of the income spectrum in 2015 made 45 percent more than its counter-

---

[1] DeSilver, Drew. "For Most Americans, Real Wages Have Barely Budged for Decades." Pew Research Center. August 7, 2018. Accessed July 13, 2019. *https://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/.*

[2] *See, e.g.,* Appelbaum, Binyamin. "One Reason for Slow Wage Growth? More Benefits." *The New York Times.* September 25, 2018. Accessed July 13, 2019. *https://www.nytimes.com/2018/09/25/us/politics/wage-growth-benefits.html.*

[3] For more on this, see Winship, Scott. "Debunking Disagreement Over Cost-Of-Living Adjustment." *Forbes.* June 15, 2015. Accessed July 13, 2019. *https://www.forbes.com/sites/scottwinship/2015/06/15/debunking-disagreement-over-cost-of-living-adjustment/.*

[4] Author's calculation using data available at *fred.stlouisfed.org.*

part in 1970, again using the PCE deflator.[5] That gain of course reflects not only rising wages but increased labor-force participation by women.

The point of providing this reassuring data is not to deny that our country has any problems with respect to absolute economic mobility. It is to identify the problems we have more precisely. The data are not uniformly positive. The median family income of 2014 was actually lower, in inflation-adjusted terms, than it was in 2000. It had risen by 11 percent from 1970 to 1985, and by another 24 percent from 1985 to 2000.

The American mobility machine has stalled out for much of this century. The trends over the last few years have, on the other hand, been pretty good, and could get better if this expansion continues.

Effective counter-cyclical policy is crucial for economic mobility.

The poor performance of household income for much of the last two decades had a lot to do with the sharp recession that began in December 2007 and the agonizingly slow recovery from it. Median family income dropped more than 7 percent from 2007 through 2011, the sharpest decline since this data series started in 1953. It did not recover completely until 2015.

When thinking about increasing absolute upward mobility, then, it is vital to consider whether our anti-recession policies are sufficiently effective. This is especially the case because the effects of recessions linger. The lost output and time in the workforce is never fully regained, and people who begin their working lives during recessions have lower lifetime incomes as a result of that timing.

In the United States, the Federal Reserve has primary responsibility for countercyclical policy. It is frequently asserted that it acquitted itself well in the response to the Great Recession. That it avoided some of the worst mistakes central banks can make is beyond dispute. But there is no reason for complacency about its record. The institution's first move after the collapse of Lehman Brothers was a contractionary one: beginning the policy of paying banks interest on excess reserves, which has depressed lending and reduced the effect of the stimulative policies that it adopted thereafter.

The Federal Reserve has consistently undershot its inflation target over the last decade and even pursued a course of interest-rate increases while undershooting it. Whether the institution will be effective in fighting the next recession, given the limited room to cut interest rates, is also in question. The Federal Reserve should give serious consideration to whether its current approach biases it toward excessively tight monetary policy, making recessions more severe and recoveries weaker than they could be and thereby suppressing growth in employment and incomes.[6]

Mobility requires higher economic growth.

But cyclical factors are not the only reason for the disappointing performance of most of the last two decades. Even before the great recession, economic growth was slower than it had been during past expansions. It was the combination of slow growth and sharp recession that made the overall economic record of 2000 to 2014 so frustrating for most Americans.

Economic growth isn't everything, but it is a prerequisite for broad-based prosperity. Reforms that would raise the rate of economic growth over the long run should therefore be a high priority.

While there is no silver-bullet solution to raising economic growth, some policy changes hold promise. One would be to continue to reform the tax code to reward investment in the United States. A particular priority should be a permanent provision allowing businesses to write off investments immediately while scaling back the deductibility of debt.

Another promising idea would re-orient our immigration system to the recruitment of individuals with economically useful skills rather than to the reunification of extended families. This shift would be conducive to opportunity, possibly in two ways. It would raise average productivity, and it might help to boost wages at the low end of the labor market. There is some, albeit disputed, evidence that low-skilled immigration has reduced the wages of high-school dropouts—some of whom, it should be noted, are themselves immigrants. It might be that relatively low-skilled immigrants would find more opportunity for upward movement in the United States if there were fewer of them.

---

[5] *Ibid.*

[6] I have written a short article on this topic recently. Ponnuru, Ramesh. "Better Inflation Targets Will Help in the Next Recession." Bloomberg Opinion. April 23, 2019. Accessed July 13, 2019. *https://www.bloomberg.com/opinion/articles/2019-04-23/better-inflation-targets-will-help-in-the-next-recession.*

Geographic mobility enables economic mobility.

A common way that Americans have historically bettered their lot is by picking up and moving from places with few opportunities to ones that are thriving. But they have been doing a lot less of that in recent years. Interstate migration rates have been falling since 1980.[7] While the reasons for this change are not well understood, one might expect—and some evidence suggests—that it has reduced wage growth, productivity, and employment rates, and at the same time increased the duration of spells of unemployment and the variation in income among regions of the country.

Public policy has likely contributed to the reduction in geographic mobility in multiple ways. Restrictive zoning laws in many jurisdictions, especially ones with rapid economic growth, have made housing expensive and thus reduced the ability of Americans in slower-growing regions to move there. A relaxation of these rules would conversely be expected to expand opportunity. But since many of the economic gains would be reaped by people who are not currently voting within those jurisdictions, while those who already reside there might see their property values decline, the political obstacles to local action are formidable.

The expansion of occupational licensure by State governments also works against mobility. In the 1950s, 5 percent of workers held jobs requiring a government license; by 2008 that figure had risen to 29 percent. Licensing can suppress economic mobility within particular communities by making it more difficult for people to begin working in the field of their choice, and it can also limit mobility among communities as relocating in a new State may require the acquisition of a new license in order to work. Licensing has been estimated to reduce interstate migration by as much as 20 percent.[8] Those who already possess licenses are, however, motivated to resist liberalization.

Many of our government benefit programs—including programs that help with housing, child care, job training, and groceries—are operated by States and localities and vary from one jurisdiction to the next. Moving can mean re-applying for benefits via unfamiliar enrollment processes. Here the path to better policy is both politically and conceptually thorny, since the problem arises from the way our government's Federalist structure has evolved.

The Federal Government may be able to exert a positive or at least counteracting influence in some of these areas. My American Enterprise Institute colleague Michael Strain has suggested that several months of unemployment benefits be made available in a lump sum to aid relocation for people seeking greener pastures.[9] But even national attention to the mobility problem may spur beneficial steps in some places.

As this brief discussion of mobility suggests, increasing it is a multifaceted challenge. It would require sustained attention to multiple policy areas, some of them Federal, some of them State and local, where obstacles to mobility have grown without notice. But if the work is difficult the potential rewards are substantial, and worth the seeking.

My thanks, again, to the Committee for the invitation to speak.

---

[7] Molloy, Raven, Smith, Christopher L., Wozniak, and Abigail K. "Declining Migration within the United States: The Role of the Labor Market." NBER. April 17, 2014. Accessed July 13, 2019. *https://www.nber.org/papers/w20065.*

[8] Johnson, Janna E., and Kleiner, Morris M. "Is Occupational Licensing a Barrier to Interstate Migration?" NBER. December 2017. Accessed July 13, 2019. *https://www.nber.org/papers/w24107.pdf.*

[9] Strain, Michael. "A Jobs Agenda for the Right." National Affairs. Winter 2014. Accessed July 13, 2019. *https://www.nationalaffairs.com/publications/detail/a-jobs-agenda-for-the-right.*

Economic Policy Institute

Let's not give up on the American Dream

Testimony before the Economic Policy Subcommittee of the U.S. Senate Committee on Banking, Housing and Urban Affairs

Testimony • By Thea M. Lee • July 17, 2019

Chairman Cotton, Ranking Member Cortez Masto, members of the subcommittee, thank you for the opportunity to speak with you today about the important concept of economic mobility. What we're talking about here, in the simplest of terms, is the American Dream—in particular, how policy choices over recent decades have eroded access to it for many Americans.

Indeed, this is the first generation of Americans whose standard of living, on average, is unlikely to exceed that of their parents, if current trends continue. Instead, too many find themselves either treading water or losing ground financially, crushed by the cumulative weight of growing wealth and income disparities. I know you are aware of the role money and influence play in our politics, but the corrosive effects of growing inequality are pervasive throughout most people's lives,[1] including restricting the economic opportunities of a broad swath of Americans, from infancy through old age.

If there is one crucial message I can deliver to you at this hearing, it is this: **The lack of economic opportunity for low-wage and middle-class American families is not an accident of history**, not a nameless economic force against which we find ourselves powerless. Rather, the highly unequal distribution of resources and opportunities within our society is a **direct result of a series of policy choices that, together, have had the effect of weakening the power of workers to defend their rights in the workplace and in the political arena, thereby tilting the playing field in favor of moneyed and corporate interests.**

Moreover, historic and ongoing discrimination in many forms and in many areas—including education, housing, and the workplace—has created obstacles to economic advancement for working women, workers of color, LGBTQ workers, and their families.

So while the subject of this hearing is economic policy, we're really here to discuss something much more fundamental: the idea of America as a nation, who we are, who we want to be, and whether we continue to strive to build a vibrant dynamic society filled with opportunity for all—or throw in the towel.

It turns out the mythology surrounding the U.S. economy is much rosier than the underlying reality. That is not to say our country does not have unique strengths, power, and resources, but rather that our failure to ensure equal opportunity across race, gender, and class both weakens our national potential and casts us in an unfavorable light compared with other wealthy nations.

Conventional wisdom holds that class barriers in this country are lower than in other advanced economies because of a perceived trade-off, which actually doesn't exist, between economic equality and economic mobility. Rich European nations are in general characterized by higher taxes, more stringent regulation, higher union density, universal health care, and a more comprehensive social contract. Conservative economists and politicians have long denounced this set of policies as "inefficient" and as creating impediments to mobility, with the result that reasonable regulations and fair levels of taxation have become politically controversial in the United States.

But the data show the results quite clearly[2]:

To the surprise of many Americans, who your father was matters a lot more to your earnings in the United States than it does in several European countries with more extensive social safety nets and much higher rates of unionization. The correlation between father–son earnings, for example, is tighter in the United States than in almost every peer OECD economy. In France, Germany, Sweden, and Denmark, for example, the correlation between a father's and a son's earnings is much lower than it is in the United States, suggesting that a low-income child in those countries has a greater chance of making it to the top than a low-income child born in the United States.

Meanwhile, the chances of moving up the income ladder have not improved in the United States in recent years.[3] Incomes at the bottom and middle of the income distribution have been squeezed while the benefits of economic growth and higher productivity have accrued largely to the wealthiest among us.

Choosing our terms carefully: Mobility as opportunity

Before I dig any deeper into the research that my colleagues and I at the Economic Policy Institute have been doing on these issues, I want to establish some basic terminology that will help inform today's discussion. In the prevailing economics literature, "mobility" is often narrowly defined as the probability that a child who is born to parents with incomes in the bottom 20 percent of households can manage to end up with an income among the top 20 percent of households by the time they grow up.

While this is a useful tool for the study of certain shifts in the economy, I want to suggest we understand the concept of mobility more broadly: It's really all about widespread economic opportunity, regardless of one's starting point in life. That, by definition, requires significant government intervention in the form of an adequately resourced education system, a strong social safety net for families during their working lives and especially in retirement, strong labor standards, laws that ensure workers who want to join a union can do so, and the kind of health care access that a universal, single-payer system can provide.

The reason some economists focus on mobility is that if people have a chance to move up the income ladder, then presumably this points to a more equitable society and also, in principle, one that rewards merit. But "mobility" alone is a tricky concept. If people are moving up a few rungs in relative income, others must by definition be going down.

In that sense, there may be a misunderstanding about the differences between mobility and inequality.[4] Mobility is the likelihood of changing one's relative position in the income distribution over time, and inequality is the distance between various positions in the income distribution at a particular point in time. A huge amount of mobility would be required to counteract the unprecedented high and growing levels of outright income and wealth inequality we are now experiencing in the United States. And that mobility just isn't there.

At the same time, surging inequality is not simply the result of poor income growth for families at the bottom and the middle. It has also been the product of runaway pay at the very top of the corporate ladder, often based on cozy relationships rather than merit, hard work, or even financial results. EPI has documented the surge in the CEO-to-worker pay ratio from around 20- or 30-to-1 in the 1960s and 1970s to between 200- and 300-to-1 in recent years.[5]

Let's not give up on the American Dream

But I'm not here solely to be the bearer of bad news, despite all the awful headlines on inequality that show just how concentrated wealth is and how that imbalanced our economy has become. I am also here to give you some good news: There's plenty we as a country, and you in particular as a legislative body, can do about the problem.

EPI has developed a wide-ranging policy agenda,[6] but I will focus on a few key areas today: strengthening workers' rights and bargaining power; using fiscal and monetary policy to the fullest extent possible to achieve and maintain full employment, which ensures that high-pressure labor markets are the norm; making the tax code more just by ensuring the wealthy pay their fair share; and implementing policies aimed at improving race and gender equity.

This hearing poses the question "Is the American Dream in Crisis?" I would answer that the American Dream is in jeopardy, but it is in our power to rescue that dream by reversing the policy choices that essentially took out a contract on the American Dream. When we review the policies needed, we need to focus especially on African Americans, who have experienced backsliding in economic opportunity, as our schools and neighborhoods have become both more segregated and more unequal.

The racial segregation of our economic system has itself been not just a stain on our history, but an active impediment, sometimes a vividly violent one, to the economic progress of people of color, particularly black Americans and many recent immigrants. White families today still possess about 10 times the wealth of black families at the median, and the black unemployment rate remains consistently about double that for whites.[7] My colleague Valerie Wilson has done important work showing the racial wage gap actually rises with an individual's educational level, countering the idea that greater educational attainment on its own can serve as an antidote to discrimination.

Race must be central to any debate on mobility

Valerie Wilson leads EPI's Program on Race, Ethnicity, and the Economy (PREE), formed in 2008 for the specific goal of creating a more focused and integrated approach to exploring and explaining how race, ethnicity, gender, and class intersect to affect economic outcomes in the United States.

Her work finds that not only is racial inequality reflected in class inequality, but racial inequality also exists within class. This is true even within the middle class, and, I would argue, is as much of a problem as the gaping inequalities between the super wealthy and everyone else.

Most Americans accept the fact that very few of us will become millionaires or billionaires, but we'd like to believe that we all have a shot at being middle class. That seems more attainable—we believe that if we finish school, get a good job, and continue to work hard, then we can attain a certain standard of living. This means more than just providing for our basic necessities like food and shelter, but also having some options in terms of the quality of those necessities (neighborhood; owning versus renting; fresh, healthy food versus processed food; providing our children with a good education). It means being able to acquire other things we enjoy that might be less essential (entertainment, a safe car, family vacations). And it means being in a position to prepare for the future (sending children to college, planning for retirement, providing assistance for an aged parent).

A solid, well-paying job is central to this vision. Household economic well-being in the United States is closely tied to the labor market because most of us get our income by working. Among the bottom 80 percent of nonelderly households, about 73 percent of household income is labor income.

So the most important pathway to the middle class is a healthy labor market that provides sufficient employment opportunities with good pay and benefits that are equally accessible to all people. Government, individuals, and institutions each play a role in creating and facilitating pathways to the middle class through the labor market.

The basic foundation of a healthy labor market is low unemployment. Until recently, the Federal Reserve often appeared resistant to keeping the monetary pedal to the metal in order to keep the job market running hot, but we welcome a recent change of tone by Chairman Jerome Powell and his colleagues. They seem to be reacting to years of disappointment in an economic recovery that is now the longest in history but was also one of the slowest, due in large part to the consistently timid commitment to full employment by policymakers starting very early in the recovery and continuing to the present. Notably, wage growth has been tepid for low- and middle-wage workers, indicating to us and many others that the job market is not quite as hot as the headline unemployment rate of 3.7 percent would indicate.

Full employment and the role of unions

Individuals can increase their productivity and access to higher-paying jobs by acquiring more formal education or developing skills through various types of training. Institutions, like labor unions, help to create pathways to the middle class for those with and without a four-year college degree—the latter still making up a majority of the U.S. labor force—by giving workers a stronger voice with which to advocate for higher pay, better benefits, training and promotional opportunities, and protections against harassment and discrimination.

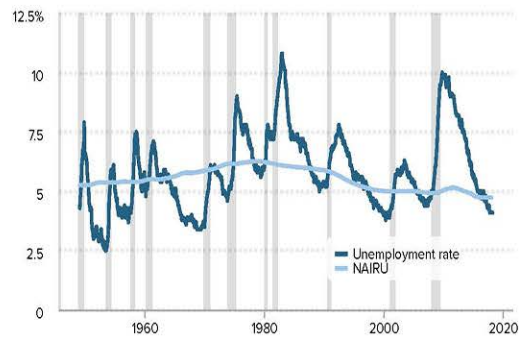
Even when these things function relatively well as pathways, we still have to contend with how the broader social structures confer advantages or disadvantages based on race/ethnicity, gender, or class that affect access to these pathways and affect how much they actually deliver to different groups.

I'm going to discuss some trends related to these three pathways, highlighting racial

Figure A

There has been insufficient vigilance in fighting unemployment since the late 1970s

Estimate of the natural rate of unemployment and actual unemployment, 1949–2018



Note: NAIRU refers to the nonaccelerating inflation rate of unemployment (another term for the natural rate of unemployment).

Source: Data on the natural rate of unemployment come from the Congressional Budget Office, "Online Data on Potential Output and Its Underlying Inputs," 2018; data on actual unemployment rate come from the Bureau of Labor Statistics, "Series ID: LNS14000000. (Seas) Unemployment Rate," accessed August 2018. Shaded areas represent recessions.

Economic Policy Institute

disparities within educational categories, which I will use as a rough proxy for class. The first trend I want to draw your attention to is the fact that there has been insufficient vigilance in fighting unemployment since the late 1970s, as seen in **Figure A**.[8]

The most obvious reason a tighter labor market is important is that more people have jobs. A tighter labor market also means a better chance for faster wage growth because there is more competition among employers to attract and retain workers. More jobs and higher wages translate into improved living standards.

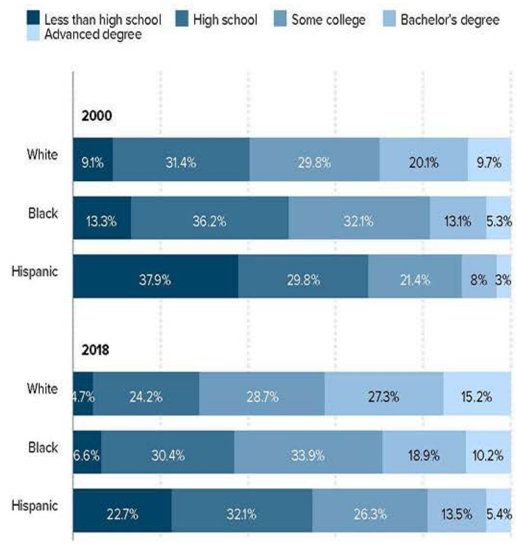
EPI and others have published research showing that full employment is particularly important for employment, wage, and income growth among African Americans.[9] The years 2000 and 2018 are the two most recent years with the lowest annual unemployment rates—4.0 percent and 3.9 percent, respectively. Since this is the closest we've been to full employment in recent years, I'm going to focus on comparisons between 2000 and 2018 as an indication of how the pathway of education has functioned in the "best of times."

Figure B shows education shares of the workforce by race and ethnicity.[10] This chart demonstrates a few things.

First, the 2018 workforce is more highly educated than the 2000 workforce. This is true for

Figure B

Educational attainment of U.S. workers by race and ethnicity, 2000 and 2018



Source: Economic Policy Institute, *State of Working America Data Library*, "Wages by Education," 2019

Economic Policy Institute

all racial and ethnic groups, but large racial and ethnic disparities in educational attainment persist.

Focusing specifically on college graduates, in 2018, 19 percent of Hispanic workers had a bachelor's degree or higher, up from 11 percent in 2000. The share of black workers with a college degree rose from 18 percent to 29 percent over the same period, while for white workers the share rose from 30 percent to 43 percent.

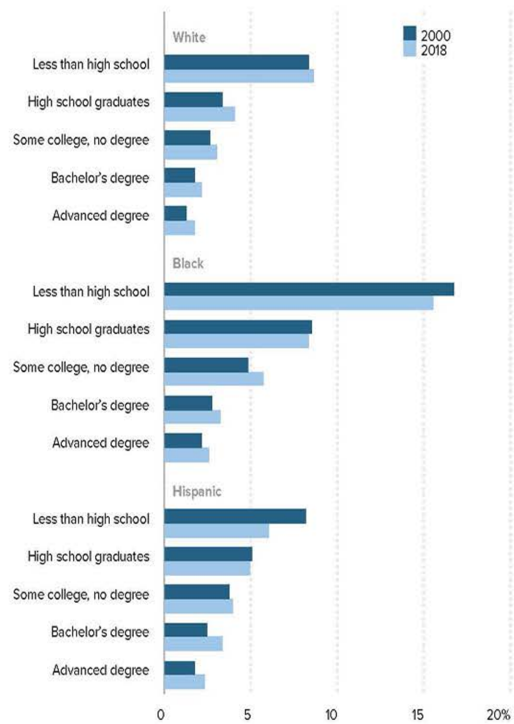
It is worth noting that although educational attainment has increased, the majority of American workers still do not have a four-year college degree.

Given these racial differences in educational attainment and the many factors that affect patterns of college attendance, completion, and affordability, clearly a college degree is not the most widely accessible pathway to the middle class and should not be the primary pathway to the middle class.

Even more challenging than the issue of unequal access to higher education is the fact

Figure C

Unemployment rate by race/ethnicity and education, 2000 and 2018



Source: EPI analysis of Bureau of Labor Statistics Current Population Survey microdata

Economic Policy Institute

that a college degree does not necessarily deliver the same returns across racial and ethnic groups.

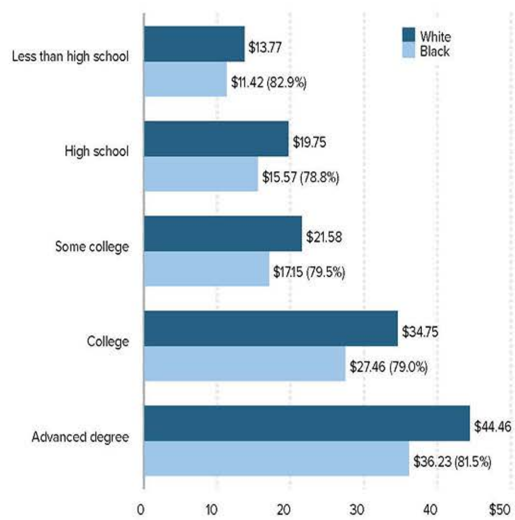
Figure C shows unemployment rates by race, ethnicity, and education.[11] On average, college graduates fare better than those without a college degree, but outcomes are not necessarily equitable across racial and ethnic groups.

In 2018, African American and Hispanic workers with a bachelor's degree faced unemployment rates that were more similar to those of white workers who have attended

Figure D

On average, white workers are paid more than black workers at every education level

Average hourly wages, by race/ethnicity and education, 2018



Note: Sample based on all workers ages 16 and above.

Source: EPI analysis of Current Population Survey Outgoing Rotation Group microdata

Economic Policy Institute

some college but have not received a four-year degree.

This chart also shows that college graduates in the 2018 labor market had higher rates of unemployment than college graduates in 2000, even at essentially the same overall unemployment rate (3.9 percent and 4.0 percent). This is true for all racial and ethnic groups.

Figure D shows average hourly wages by race, ethnicity, and education in 2018.[12] On average, white workers are paid more than black and Hispanic workers at nearly every level of education (except for those with less than a high school diploma). This is particularly pronounced among college graduates.

This statistic should really challenge us to consider what it takes to reach middle class status, and how that experience varies by race and ethnicity.

The final trend I want to highlight as it relates to pathways to the middle class is the decline in union membership. Unions have played a critical role in opening pathways to the middle class because they improve wages and benefits for all workers, not just union members. On average, a worker covered by a union contract earns 13.2 percent more in hourly wages than someone with similar education, occupation, and experience in a nonunionized workplace in the same sector. This premium is even higher for African Americans (14.7 percent) and Latinos (21.8 percent).

Union membership has declined significantly since 1989, and especially among African Americans, who have had the highest rates of union membership throughout this period.[13]

What should we do? Some policy recommendations

I'd like to outline some key federal and state policies that would promote more widespread prosperity.

First and foremost, Congress must take the long-overdue step of raising the minimum wage to $15 an hour. The Raise the Wage Act is key to ensuring a floor for the pay of low-wage American workers, who have seen the value of their earnings erode dramatically over time.

Extensive research from EPI and others has shown that a higher minimum wage would boost pay for some 27 million Americans and be unequivocal good news for working families. It would stimulate local economies by putting more money in the pockets of those who will spend it.

Second, legislators should pass the Protecting the Right to Organize (PRO) Act, since this would considerably boost workers' ability to form unions and bargain collectively for wages and benefits.[14] The erosion of union membership and organizing in this country compared with other rich nations can be directly tied to the much higher inequality and worse health and social outcomes the United States experience versus its rich peers.

Third, Congress should continue to hold the Federal Reserve accountable for the maximum employment side of its mandate. We are encouraged to see that years of research and activism from the Center for Popular Democracy's Fed Up Coalition, which relied heavily on EPI research and assistance, appear to have strongly affected Fed officials' views. Fed Chairman Jerome Powell recently stated, in agreement with EPI's view, that the labor market should not be described as hot despite a historically low jobless rate of 3.7 percent—particularly given a lack of consistent and robust wage growth. This stands in sharp contrast to the many voices inside and outside of the Fed who, at an earlier time, believed there was no way the jobless rate could fall below 5 or even 6 percent without generating undue inflation.

Fourth, Congress must rediscover fiscal policy as a tool to not only address economic downturns but also to target government spending toward addressing structural needs, like infrastructure investment and employment programs targeted at poorer communities.

Fifth, the U.S. government must renew its commitment to a public education system, from early childhood through college, that is child-focused and that empowers teachers as professionals who are free to tailor their teaching rather than rely on pure standardization.

Last, but certainly not least, Congress must make a serious effort to address long-standing and ongoing racial inequities in housing, employment, and wealth. Employers must be compelled to implement intentional strategies to extend employment opportunities to a more diverse pool of applicants. The Federal Reserve must use all its powers under the Community Reinvestment Act to ensure redlining and lending discrimination does not persist or worsen.

—

Sadly, the American Dream is in serious danger of slipping away. But we have an opportunity and a path forward to ensure that it stays alive for all Americans and for future generations.

—

Thank you for the opportunity to speak to you today, and I look forward to your questions.

1. Paul Krugman, "Notes on Excessive Wealth Disorder," *New York Times*, June 22, 2019.

2. Elise Gould, *U.S. Lags Behind Peer Countries in Mobility* (economic snapshot), Economic Policy Institute, October 10, 2012.

3. Raj Chetty, Nathaniel Hendren, Patrick Kline, and Emmanuel Saez, "Economic Mobility," in *Pathways' State of the States: The Poverty and Inequality Report 2015*, eds. David Grusky, Charles Varner, Marybeth Mattingly, Stanford Center on Poverty and Inequality, 2015, 55–60.

4. Elise Gould, "Mobility Needs to Do More Than Stagnate to Indicate U.S. Economy Is Performing for Low- and Moderate-Income Families," *Working Economics Blog* (Economic Policy Institute), February 12, 2014.

5. Dean Baker, Josh Bivens, and Jessica Schieder, *Reining in CEO Compensation and Curbing the Rise of Inequality*, Economic Policy Institute, June 4, 2019.

Lawrence Mishel and Jessica Schieder, *CEO compensation surged in 2017*, Economic Policy Institute, August 16, 2018.

6. Economic Policy Institute, *Policy Agenda*, last updated December 5, 2018.

7. Lisa J. Dettling, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, and Jeffrey P. Thompson, "Recent Trends in Wealth-Holding by Race and Ethnicity: Evidence from the Survey of Consumer Finances," *FEDS Notes* (Washington: Board of Governors of the Federal Reserve System), September 27, 2017.

8. Chart appears in Josh Bivens and Ben Zipperer, *The Importance of Locking in Full Employment for the Long Haul*, Economic Policy Institute, August 2018.

10. Data for this chart are from Economic Policy Institute, *State of Working America Data*

Library, "Wages by Education," 2019.

12. This chart appears in Elise Gould, *State of Working America Wages 2018*, Economic Policy Institute, February 2019.

13. EPI analysis of Current Population Survey microdata, 1989–2017.

14. Celine McNicholas and Lynn Rhinehart, "The PRO Act: Giving Workers More Bargaining Power on the Job," *Working Economics Blog* (Economic Policy Institute), May 2, 2019.

Economic Mobility: Is the American Dream in Crisis?

United States Senate
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Economic Policy
July 17, 2019

Statement of Keith R. Miller
Principal, Franchisee Advocacy Consulting

Chairman Cotton, Ranking Member Cortez Masto, and members of the Subcommittee and Committee, thank you for the opportunity to speak to you today. My name is Keith Miller. I am a 30-year franchise owner of Subway. Notice I use the term "franchise owner". While more commonly called a franchisee, and I will often use that term today, I prefer "franchise owner" reminding everyone that when you buy a franchise, you own something, you are an owner. I am a past president of the North American Association of Subway Franchisees (NAASF) and for 6 years, I was chair of the Coalition of Franchisee Associations (CFA), the largest franchisee-only organization in the country. I have long been an advocate for franchise owners. In 2018, I started a small business, the Franchisee Advocacy Consulting with the tagline, "Advancing franchisee causes through engagement and advocacy". I have been a voice in the industry for those that are not able to speak or are afraid to speak up.

With my background and expertise, today I will speak specifically about the franchise industry, the good, the bad, the ugly. I will talk about the opportunities the industry provides to realize the American Dream, and how that dream can turn into a nightmare. I will discuss about how the government has become an enabler for bad franchises, and finally, I will discuss oversight and transparency which I believe will clean up the industry and help rebuild some trust to help others realize the American Dream.

The franchise industry is large[i], and, over time has allowed many to realize their American Dream. The lodging industry, for example, is one that has allowed many early-generation immigrants to successfully own their own business and prosper. There are many examples of great brands that have provided these opportunities. The franchise business model itself is a brilliant business model, and one I support. However, because of little transparency and oversight, it is also an industry with far too many examples of predatory franchise companies that take advantage of prospective entrepreneurs and leave them overworked, despondent and broke. We hear the lure of the industry as it advertises to be your own boss, with proven business models, and no experience necessary. On top of that, the industry targets those most vulnerable; immigrants, veterans, and retirees. Remember, I am a small business owner myself, hardly one that advocates for an abundance of regulation. But, in the case of the franchise sector, the government provides inadequate oversight and access to money which can encourage fraud and lead to failed businesses and demoralized business owners.

Let's first talk about oversight. Most believe that this large sector is heavily regulated. The Federal Trade Commission (FTC) does regulate presale disclosure through the Franchise Rule. The FTC requires a prospective franchisee receive a Franchise Disclosure Document, or FDD. But I ask, how many of you knew that the FTC doesn't even collect the FDD, and on the first page of all FDDs it specifically states in bold print, "**Note, however, that no governmental agency has verified the information contained in this document**". The FTC permits franchisors to write terms into a contract that denies franchisees the right to buy goods from a lower-cost source, prohibit franchisees from organizing into an association and even bans them from sharing their experience with current and future franchise owners. It permits contracts that allow franchisors to provide fraudulent financial information outside of the FDD. The FTC allows contracts that force franchisees into arbitration which can make it easier for the franchise corporation to take the outlets of successful franchisees through minor infractions. I wouldn't call that heavily regulated.

Why is this important? Let's look at the securities industry for example. If you invest $100,000 in a stock, what is your risk? Well, worst case, you could lose your entire investment, so your risk is $100,000. Now let's look at a franchise, so I'll ask the same question, if you invest $100,000 in buying a franchise, what is your risk? No, it's not the $100,000 you invested; it's much more, it's all the assets you own! Personal guarantees are required in most franchise agreements, and often extend to the immediate family, so a separate business entity provides little to no protection of personal assets. Yet here we have an industry with no governmental agency even reviewing the documents. In addition, once the ink is dried on the signed franchise agreement, there are no federal laws or regulations specific to the franchise industry to manage the relationship of that investment. There are 19 states that do have some level of relationship laws. This lack of oversight is vastly different from any industry I can think of when it comes to protecting the investors. Most laws and regulations are there to protect the investors first. Boards of directors have that fiduciary responsibility to protect those investors. In the franchise industry, the primary investor, as a class, is the franchise owners. However, the franchisees are not shareholders, they are considered stakeholders, therefore the franchise company has no such fiduciary responsibility to them or their investment.

Let's look at some numbers. Franchise Grade, a market research firm that analyzes franchisee investment risk published an article titled, "Can A Few Bad Apples Spoil the Industry Investment?"[ii] It looked at 1,900 franchise systems, using disclosure information from 2010 through 2014. In that 5-year period, they noted 168,585 new business units had opened, but also that 138,825 businesses had closed, for a net gain of only 29,760 businesses. Even more concerning was the difference between the top and bottom quartiles. While the bottom quartile accounted for 25% of the openings, it closed double the outlets opened and accounted for 61% of all closed outlets. With full disclosure and better oversight, very few of those failing stores would have opened and many entrepreneurs and employees would have been better off.

If this high level of failure were happening with private capital, it would be bad enough. But the Small Business Administration's loan guarantee programs enable failure and fraud. In 2013, the Government Accountability Office released a report (GAO-13-759) that showed during the previous 10 years, "SBA guaranteed franchise loans under its 7(a) program totaling around $10.6 billion. SBA made guaranteed payments on approximately 28 percent of these franchise loans, representing about $1.5 billion."[iii] This means that twenty-eight percent of franchise loans saw the owner not only lose their business, but all their assets. Franchise owners post significant collateral – their savings, their homes, other land or property they hold. When SBA loans are charged off, this means the franchise owner has already lost her or his collateral. Charge offs are paid for by higher fees charged to future borrowers and lenders and occasionally, the taxpayers. In fact, charge offs in the 7(a) program are so high now that the Trump Administration requested an appropriation of $99 million.[iv] Defaults should be rare, and for many franchise brands they are. But some franchise brands have very high levels of defaults, a fact that is very difficult for a potential franchise owner to learn.

Too many – the franchise corporations, the SBA, some in Congress -- only look at SBA funds showing how many businesses have opened, and how many jobs they created. Unfortunately, none of them stand up and count the businesses that fail, and the jobs that are lost. Failing franchisees cannot pay good wages. Some have nearly no employees; the franchise owners and family members work non-stop just to keep the business afloat. Franchise owners struggle to pay back the loan and meet the terms of a decades-long contracts.[v] Failing franchisees struggle to pay any wages and payroll taxes.

This concern is bipartisan. Ranking Member Cortez Masto recently sent letter outlining her concerns of four specific brands to the SBA and asking for loan performance information on these brands.[vi] In 2014, then Senator and Budget Ranking Member Jeff Sessions inquired about the "moral hazard" that was created by the SBA when banks can profit from poorly underwritten loans.[vii]

Let's look at some examples of the breakdown in this industry, and how dreams have been shattered. Amin Abdelkarim is an immigrant from Egypt, who moved to the Dallas area. He worked double shifts at the Dallas

Fort Worth airport and saved enough money to think about going into business, in search of his American Dream. He ended up purchasing a Dickey's Barbecue Pit franchise. He was given the FDD, and a spreadsheet showing estimated startup costs, and was provided assistance with applying for an SBA 7(a) loan. Unfortunately for him, the estimates given were grossly incorrect, and all his startup capital was spent getting the business open. He opened his business in August 2018, and Amin contacted me in September 2018, one month after opening, asking for help. He was already broke, he could not pay his SBA loan, and feared he would lose his home, rendering his family homeless. Dickey's idea of assistance was reminding him of the 60-month liquidated damages clause in his contract. His other option was to sell his business to a buyer Dickey's found, for pennies on the dollar. Either way, he knew his SBA loan was going in default, and he was going to lose all his assets. At one point he said to me, "in a few weeks, I will find myself, my disabled wife, and my 89-year old mother in law in the street, with no house, no car, and no money".

Some will argue, it's his fault, he didn't have the skills to be a business owner. This is what franchisors will always blame, the franchisee was not a good owner, so it's not the company's fault.

Here's the problem in the industry.

When a franchise is sold, both the franchise corporation and the franchise business should profit. However, the franchise corporations, brokers, and/or "consultants" make money up front. They earn a profit from the initial franchise fee, then the franchise corporation continues to make money on the ongoing royalties, most often based on revenue, not profit. The franchise corporation has little risk, while the franchise owners often struggle to make a decent living.[viii] The franchise owner has all the risk. The bank profits from the loan, a loan they often would not approve without the SBA's guarantee. In fact, banking regulators do not even consider government-guaranteed loans and do not get involved when those loans fail.

You may wonder why the SBA continues to guarantee loans when in fiscal year 2018, Dickey's started with 562 units, opened 72 new units, yet had terminations and ceased operations of 113, for a net loss of 41 outlets.[ix] Add in 44 transfers, many of them forced for pennies on the dollar, and you have a disorderly attrition rate of 28% of the total outlets in a single year. During the last 10 years, Dickey's took out 246 SBA loans, and 41, or 17% have been charged off. A recent survey of 201 of 336 Dickey's BBQ store operators representing 330 stores, found that 85% of current store owners would NOT open a Dickey's franchise. Of those 201 store owners, 84% said that buying a Dickey's franchise did NOT meet their expectations. These results do not include Amin and others like him who no longer have their store. And it's not just Dickey's - the SBA has a history of backing poor performing brands.[x]

Companies' pushes to sell more franchises has led to many franchisees that should not have been provided access to government-guaranteed loans. Again, many profit without risk. But take, for example, Experimac.[xi] This is a brand that started franchising in 2016. At the end of 2018, their disclosure document showed 101 franchised units in the United States. They started franchising just 3 years ago, yet have received 77 SBA approved loans, of which 23, or 30%, have already been charged off. Experimac is part of the United Franchise Group, which markets multiple franchises. They send prospective franchisees to a hand-picked loan broker. UnhappyFranchisee.com reported that this loan broker participated in a podcast in 2017 where he stated he had coordinated funding for 70 Experimac franchise owners, including facilitating SBA Express loans through Celtic Bank, 401k Rollover for Business Start-up (ROBS), and equipment leases. He further stated that financial projections are the biggest challenge but commented "I do that".[xii] This means he could provide financial projections that were not part of the FDD and would not be violating any kind of disclosure requirements.

Mark Shor retired from his IT job at a university and bought an Experimac franchise in Henderson, just outside of Las Vegas area. The franchisor directed him to the loan broker mentioned above that helped him apply for and obtain an SBA 7(a) loan from Celtic Bank. The loan broker provided him a projection spreadsheet that showed nearly $700,000 in profits for the first year, $995,400 the second year. The current FDD shows the highest volume franchised location at revenue of $822,375, with an average unit doing $410,639. I personally was contacted by this franchise group, and when I asked if I could expect to do revenue of at least $500,000, I was told in an email from a company representative that they have "locations in our Million Dollar Club". This of course is false. Mark has continued to work his business, still open while those around him have closed, but still bleeding cash. The only way he is surviving is by monthly dipping into his retirement to pay the SBA loan to keep it current. While he may be the exception and not default his loan, his retirement nest egg will be painfully depleted.

Complete Nutrition is a shocking story of abuse of franchise owners. At the beginning of March this year, the Complete Nutrition franchise notified franchisees that at the end of March, they would no longer be a franchise company. Franchisees could continue as a retailer for the nutrition company with no support from the company or could opt out of their contract for a $10,000 termination fee. On April 1, the Point of Sale system for franchisees was cut off, but not before the company data mined the customer information. A few days later, an email went out telling all customers that their local Complete Nutrition had been sold but not to worry, customers could order online 24/7. A few days after this, the company claimed that was a mistake, but is that really believable? Franchisees have told me that the company continues to market to their old customer base, selling products online significantly cheaper than they can in the brick and mortar location. Many of these franchisees recently bought into Complete Nutrition, at a price of $49,500, but now have a franchisor that has cut them off and is stealing their customer base. More than half the Complete Nutrition locations were financed using SBA loans. Before the recent actions, 12% have been charged off over the last 10 years.

Michael Hataway is a Complete Nutrition franchisee in Reno. Since the franchisor has pulled support, sent out the email that they have been sold, and aggressively marketed online sales, his sales have crashed. His finances and personal life are in shambles and he is heading towards default of his SBA loan. Jamie Stephens, a franchisee with 5 stores in North Dakota and one in Minnesota had 5 SBA loans totaling around $1.5 million when Complete Nutrition completely changed their business environment. But don't worry, the franchisor has kept their $49,500 franchise fees collected per outlet, some from the last few years.

Finally, Huntington Learning Centers. This brand, and the SBA lending to it, prompted an SBA Inspector General audit (Report No. 11-16) in 2011. The IG found that SBA 7(a) loans to Huntington Learning Center franchises had significantly inflated first year revenue projections.[xiii] Bob Spada from Connecticut was one such franchisee. He was given a loan consultant to work with and applied for a loan with Banco Popular. His first-year revenue projection given was just over $500,000, and he received a $300,000 loan. As he started to fail, he wondered why he was so short of projections. He found others opening at the same time were also far short of their projections. Then he found out that actual first year revenue numbers for an average center was really $249,000, less than half his projection. A mature location had average revenue in the low $400,000s. As he dug into the reasons for this projection, he discovered the devious means. To qualify for that $300,000 loan, he would need about a $75,000 profit that first year to meet the required debt service coverage ratio. To reach that profit level, and reverse engineering the numbers, you would need just over $500,000 in revenue. The numbers given to all these franchisees were false. It was clear that Huntington's consultant had reverse engineered the profit numbers just to qualify for the loans. And when the loan was funded, Huntington

Learning Centers collected a $60,000 franchise fee. Banco Popular sold these loans off on the secondary market for a nice profit. The only one really left with the liability was Bob, the franchisee. Bob was forced to file bankruptcy and lost everything. He's also an example of the true cost of to the economy. While the SBA claims the costs/losses are managed within the program, that is only true for the SBA loan amount. In reality, Bob, in an effort to make the business a success ran up huge credit card debt and got a home equity loan. The total losses of his mortgage, equity loan, and credit cards more than doubled the losses of the SBA loan. Who accounts for that loss to the economy?

Corrective Action Steps are Possible

When an industry tolerates deception and fraud, it is damaging to those entrepreneurs who see their dreams become nightmares. It is terrible for communities when stores close, jobs are lost, and homes are foreclosed. Here are some steps that need to be taken to rectify some of the issues in the franchise industry. Many are contained in the Coalition of Franchisee Associations' comments to the FTC of the Franchise Rule Review, which is attached. Some of those highlights are:

- Provide adequate resources and ensure staff will review compliance of the Franchise Rule, make the disclosure documents publicly available, and confidentially receive complaints so the franchisee is not subject to retaliation.
- Provide for a Private Right of Action. It is obvious the FTC does not have the resources nor the priorities to enforce their own Franchise Rule. A private right of action would provide damaged franchisees the right to sue for violations. Congress must legislatively make this change.
- Prevent FDDs from including disclaimers which allow franchisors to amend their policies outside the specific language of the franchise agreement. This is most often accomplished by including a statement that the franchisee must follow all policies in the most current Operations Manual. However, items often included in the Operations Manual are not operational issues, but contract changes. For example, including a section that limits how many outlets you can sell to a single buyer.
- Require the FDD be a binding contract for the term of the franchise agreement, which may be 5, 10, or up to 20 years. If the FDD is used as the part of the due diligence in purchasing the franchise, and the franchisor can change any of the practices that have been disclosed, then what value is the disclosure?
- Prohibit disclosures outside of the FDD, made both informally and by third parties.
- Make all FDDs publicly available on the FTC website.
- Increase disclosures on revenues, costs, loan repayment, defaults, and other data for both first year and mature units.

The next step is to require increased FTC disclosure of brands qualifying for SBA 7(a) loans. Any franchise owner receiving an SBA loan should get 1) disclosure of average first year revenues for franchised outlets and 2) disclosure of first year ceased operations and transfers. While opponents will claim that they do not want more government oversight on private business, they have no problem asking for government-guaranteed money to line their pockets. This change is not to curtail SBA lending, but to ensure more money is provided to viable brands at reduced fees and rates.

Finally, it is time for Congress to pass comprehensive franchise relationship legislation that protects franchise investors after the contract is signed. This legislation should include:

- Rights to association without interference or retaliation and an end to non-disparagement clauses that prohibit potential franchise owners from learning about the business from current franchise owners.
- Termination rights, to ensure fair due process is afforded to all franchise owners.
- Transfer rights, to ensure the right to transfer and monetize the equity the franchise owner has earned.
- Property rights to ensure the franchise owner is protected on the assets they have paid for.

Conclusion:

In summary, the franchise business model can be, and should be, a model for economic mobility, and realizing the American Dream for generations. However, leaving the industry to police itself is not working, and destroying many lives, while profiting a few individuals and corporate executives. There is no reason for this. Access to SBA money should be the model of transparency of the industry, one that ensures the best underwriting procedures. The industry forgets who the real investors are, the franchise owners, and their government fails in protecting those who invest, employ, support, and pay taxes in every community across this country.

---

[i] International Franchise Association. National Impact of Franchising. Updated 2018. Retrieved from https://franchiseeconomy.com/

[ii] Franchise Grade. "Can A Few Bad Apples Spoil the Industry Investment?" May 5, 2015. Retrieved from: https://www.prweb.com/releases/2015/05/prweb12698529.htm

[iii] GAO. Review of 7(a) Guaranteed Loans to Select Franchisees. GAO-13-759: Published: Sep 10, 2013. Retrieved from: https://www.gao.gov/assets/660/657723.pdf

[iv] U.S. Small Business Administration, FY2020 Congressional Budget Justification and FY2018 Annual Performance Report, 2019. Pages 34-35. Retrieved from: https://www.sba.gov/sites/default/files/2019-04/SBA%20FY%202020%20Congressional%20Justification_final%20508%20%204%2023%202019.pdf

House Small Business Committee Democratic Staff. The FY 2020 Presidential Budget: Missed Opportunities for Small Businesses. March 2019. Retrieved from: https://smallbusiness.house.gov/uploadedfiles/the_fy_2020_presidential_budget_final_.pdf

[v] Bennet, Julie. Franchise Times. "Taking off the gloves; Commercial cleaning franchisees sue." August 2009. Retrieved from: https://www.llrlaw.com/wp-content/uploads/2015/10/Taking-off-the-Gloves-%E2%80%93-Commercial-cleaning-franchisees-sue.pdf

Unhappy Franchisee. Complaints about Jani-King. Retrieved from: http://www.unhappyfranchisee.com/jani-king-franchise-complaints/

[vi] Senator Cortez Masto letter to SBA. Retrieved from: http://www.unhappyfranchisee.com/wp-content/uploads/2019/05/2019-May-22-Cortez-Masto-SBA-Franchise-Issues.pdf

[vii] Clark Patrick. Bloomberg. "A Senator Sees 'Moral Hazard' in SBA Loan Program". May 15, 2014. Retrieved from: https://www.bloomberg.com/news/articles/2014-04-15/a-senator-sees-moral-hazard-in-sba-loan-program

[viii] Patton, Leslie. Bloomberg. "U.S. Franchise Owners Say They Can't Earn A Decent Living". April 30, 2015. Retrieved from: https://www.bloomberg.com/news/articles/2015-04-30/u-s-franchisees-say-they-can-t-earn-decent-living-survey-says

[ix] Maze, Jonathon. Restaurant Business Online. "Dickey's Barbeque Pit Closes 113 Units". September 14, 2018. Retrieved from: https://www.restaurantbusinessonline.com/financing/dickeys-barbecue-closes-113-units-franchisees-bolt

[x] Clark, Patrick. Bloomberg. "Franchise Loans Keep Blowing Up, and the Government Keeps Backing Them", May 14, 2015. Retrieved from: https://www.bloomberg.com/news/articles/2015-05-14/franchise-loans-keep-blowing-up-and-the-government-keeps-backing-them

[xi] Kelly, Sean. UnhappyFranchisee.com. "EXPERIMAC Franchise: Who Benefits from Failed Franchises?" February 8, 2019. Retrieved from: http://www.unhappyfranchisee.com/experimac-franchise-fail/

[xii] Kelly, Sean. Unhappy Franchisee.com. "EXPERIMAC, UFG Franchise Funding Trap: The Paul Bosely Interview". February 15, 2019. Retrieved from: http://www.unhappyfranchisee.com/paul-bosley-experimac/

[xiii] SBA Inspector General. "Report 11-16 - Banco Popular Did Not Adequately Assess Borrower Repayment Ability When Originating Huntington Learning Center Franchise Loans". Retrieved from: https://www.sba.gov/content/report-11-16-banco-popular-did-not-adequately-assess-borrower-repayment-ability-when-originating-huntington-learning-cen

CFA Response to FTC Franchise Rule, Matter No. R511003

The Coalition of Franchisee Associations (CFA), representing more than 35,000 franchisees who own over 85,000 businesses, which employ over 1.4 million individuals, is the largest franchisee-only association in the country. Its members make up the largest and most reputable independent franchisee associations with a mission "to leverage the collective strengths of franchisee associations for the benefit of the franchisee community." The CFA, with headquarters in Washington, DC, is committed to providing support and assistance to the franchisee community at large. The CFA represents franchisees only and is not conflicted by outside interests.

We are writing regarding the March 13, 2019 request for public comment made by the Federal Trade Commission (FTC) regarding the Franchise Rule, specifically: Franchise Rule Regulatory Review, 16 CFR part 436, Matter No. R511003.

First, is there continuing need for the Rule? The CFA believes there is absolutely the need for the Rule to continue, but with modifications that increase transparency to prospective franchisees. While there is a wealth of information available, CFA requests several changes that increase the value of that information and the clarity of the Franchise Disclosure Document (FDD). The importance to the prospective franchisee and the lending community is simple - investing in a franchise likely carries more risk and liability than any other investment they will make in their lifetime. While investing in a security puts the investment at risk, investing in a franchise puts all the franchisee's assets at risk, and failure most often brings on financial destruction. Literally, the franchisee is "all in"!

General Areas to Improve the Franchise Rule

- Designate adequate resources to provide for full oversight and enforcement of the Franchise Rule ("Rule"). As part of the Rule, the FTC requires the FDD to be provided but completes no verification process to validate the Rule has been satisfied. This leaves prospective or new franchisees to individually determine whether all necessary information has been properly disclosed. However, in efforts to sell the franchise, prospects often rely on the franchisor's statements such as "be your own boss, no experience necessary, proven business model". Based on this, and the fact that the FTC considers this a consumer transaction, a more comprehensive level of oversight is needed.

- Provide for an FTC-designated "whistleblower" status for complaints. If an active franchisee files a formal complaint with the FTC, that franchisee puts his or her livelihood at risk. Disclosing possible Franchise Rule violations is often followed by franchisor retaliation in the form of increased franchise agreement violations and risk of termination. Because of this fear, few complaints are filed by franchisees, and by the time it is safe to file complaints, the statute of limitations has often passed.

CFA, Inc. | 1750 K St. NW, Suite 200 | Washington, DC 20006 | p: 202-416-0270 | f: 202-416-0269 | www.thecfainc.com

COALITION OF FRANCHISEE ASSOCIATIONS

- <u>Prevent FDDs from including disclaimers which allow franchisors to amend their policies outside the four corners of the franchise agreement.</u> The language contained in the FDD is binding as of the day it is provided to the prospective franchisee. With the increase in private equity and public ownership, past policies and disclosures are often not followed and new policies can create a far different business model than previously disclosed. Operations Manuals are often used to modify practices far outside the scope of the expectations for an Operations Manual, and in fact change the terms of the franchise agreement.

- <u>Eliminate the mandate that franchisees must waive their private right of action for Franchise Rule violations and eliminate pre-dispute binding arbitration clauses in FDDs.</u> Without a private right of action, and limited resources at the FTC, franchisees have little recourse against the harm due to violations of the Franchise Rule. Without the private right of action, franchisees must file in a court system which requires proof of franchisor intent to violate the Rule, an almost impossible standard required under common law fraud.

- <u>Require the FDD (including the franchise agreement) to be a legally binding document for the term of the agreement, regardless of changes in franchisor ownership.</u> Currently, the FDD is only valid the day it is received by the franchisee. That means, for example, that franchisors may price their product at a certain rate, only to have it substantially increased under new ownership. That can completely change the business model and makes the FDD disclosure invalid, although it was truthful on the day received. As a result, there is no recourse available to the franchisee. Since the franchisee is buying into the franchise based on the information provided in the FDD, that FDD should be binding.

- <u>Prohibit disclosures outside of the FDD, made both informally and by third parties.</u> Oftentimes, franchisees receive false earnings claims from franchise brokers or consultants who claim to work on behalf of the prospective franchisee but receive all their compensation from the franchisor upon the signing of a franchise agreement. Additionally, the prospective franchisee is often provided, by the franchisor, with a loan consultant who provides earnings figures so the franchisee can qualify for a loan to purchase the franchise. These loan consultants often help franchisees obtain government-guaranteed SBA 7(a) loans. In these cases, revenue and profit numbers are being provided to the prospective franchisee with no consequences to the franchisor or third parties who profit from these transactions.

CFA, Inc. | 1750 K St. NW, Suite 200 | Washington, DC 20006 | p: 202-416-0270 | f: 202-416-0269 | www.thecfainc.com

COALITION OF FRANCHISEE ASSOCIATIONS

Specific Suggestions for Improving the Franchise Rule

- Make all FDDs publicly available on the FTC website on a 10-year rolling basis. Currently, the FTC does not require proof of an FDD to comply with the Franchise Rule; confirmation of an FDD only occurs if a complaint is filed with the FTC. In today's electronic age, franchise companies should be required to submit an electronic version of the FDD and post on the FTC website where it is easily located by a public search engine. California, Minnesota, and Wisconsin all provide this capability for franchises selling in those states and the technology is readily available.

- Make FDDs readable via handheld devices. Because the FDD is often hundreds of pages long, it is cumbersome and somewhat overbearing for a prospective franchisee to read and understand the importance of each section. It is time to modernize the Franchise Rule and make it available on handheld devices, with hyperlinks in the table of contents, a summary page of key information and other tools with which to help franchisees navigate.

- Codify the "Good Faith and Fair Dealing" provision in the Rule to place an affirmative duty on both parties. Franchisees rely on the franchisor to provide useful, accurate, and meaningful information in making a purchase decision to buy a franchise. This information should be disclosed in good faith.

- Require documentation to substantiate figures so as to reduce the frequency of false earnings claims, investment requirements, and other monetary outlays. Franchisors should be required to provide all information needed to justify the figures provided in the FDD. While this process maybe time consuming, franchisees are often investing their life savings into a business based on these figures and should have reliable data on which to rely.

- Item 1 improvements:
  - Identify corporate entity history, including "Chapter 11" filings and ownership changes for all corporate parents and entities. This additional information is important to understand the background of a franchise in which the prospective franchisee is considering investing.

  - Require disclosure of citizenship for LLCs. Franchisors that are limited liability companies should be required to disclose the citizenship of their members and, if their members are also LLCs, their citizenship as well. In order to obtain jurisdiction in federal court under diversity of citizenship, it is necessary to allege the citizenship of all members of a limited liability company. Franchisees are therefore encumbered in their ability to sue in federal court without this information, which is not otherwise publicly available.

- Item 3 improvements:
  - Enhance information required to include all legal disputes. More details regarding legal disputes need to be included so that a prospective franchisee can determine whether there are issues which impact their purchase. Simply providing the names of the parties and a case number is insufficient; prospective franchisee should not be expected to access case files or pay an attorney to get additional information.

- Item 19 improvements:
  - Mandate the disclosure of detailed revenues, costs, and profits. Given the monetary risk for a prospective franchisee and the potential income for the franchisor, disclosure of these numbers should be required. For newly-formed franchises, franchisors can provide these disclosures for any currently-available outlets. While the time and cost of meeting this higher standard may be significant, the cost of not providing this data to prospective franchisees and the risk to the economy is even higher.

  - Provide first year mean (average) and median (midpoint) revenues for the previous three years. Many brands have a "ramp-up" period to get to reported average sales. Loans - specifically SBA 7(a) loans - often used in franchising require a first-year revenue estimate. Using the average for all outlets may give false information for that first-year estimate and without valid information, the franchisee may not have enough working capital to survive the ramp-up period. Franchisors can easily provide these figures at no additional cost.

  - Include a requirement to disclose the need to service a loan repayment if applicable. While profit figures alone may be appealing to a prospective franchisee, the inclusion of debt expenses may paint a different picture. The inability for franchisees to service their debt is a primary reason for failure in the industry. Franchisors fully research the financial capability of prospective franchisees; they should therefore provide and disclosure figures regarding the amount borrowed to open the franchise.

  - Include a statement that outlet EBITDAR or EBITDA figures do not provide coverage for debt service or future year remodel/capital expenditure levels that the franchisor may require.

- Coordinate with the current NASAA Commentary now requiring additional disclosures in many registration states - most franchisors must now comply with these requirements. Therefore, a uniform, federal standard is strongly recommended.

- Item 20 improvements:
  - Include a multi-year list (including contact information) of franchisees who are no longer in the franchise system. Providing contact information of prior franchised outlets is worthless as part of the due diligence process, since that outlet is either closed or has transferred to a new franchisee. Prospective franchisees should have the opportunity to not only hear from current franchisees but also from those who have left the franchise system. The current franchisee list, as well as initial forwarded contact information for former franchisees, is readily available by the franchisor.

  - Include a rolling 10-year review of cumulative turnover. Turnover, in the form of terminations, ceased operations and transfers, is one of the most important measurements of how a franchise is performing as well as the status franchise relationship. Too often, the industry measures success based on the time period the outlet has remained open. If a franchisee, however, loses his or her investment and transfers to a new owner for a significant loss, this information should be made available to prospective franchisees. Disclosure of 10-year cumulative turnover will better measure success. The data is readily available and therefore is of no cost to the franchisor.

  - Mandate disclosure of first-year ceased operations and transfers. A high initial number is often a "red flag" for prospective franchisees and the franchisor can provide this data at no additional cost.

  - Require disclosure of mandated transfers or transfers due to franchisee termination. Many franchisors, upon termination, allow for a franchisee to sell within a limited timeframe However, this also creates a situation where the franchisee is unable to fully monetize the value of their franchise. A franchise with many terminations will likely be viewed differently than one with significant transfers, and this should be properly reported. Franchisors have full knowledge of this information and can provide it at no additional cost.

  - Specifically list former franchisees who signed nondisclosure and/or confidentiality agreements. If former franchisees are forbidden to discuss their experiences, that information should be included in the FDD. A high number of nondisclosure and/or confidentiality agreements can be a concern to prospective franchisees.

COALITION OF FRANCHISEE ASSOCIATIONS

- Detail the causes for terminations via a standard table. If franchises have excessive terminations, it may point to an unstable system. For example, reasons for termination could include abandonment (which is really a ceased operation), nonpayment of royalties (which points to an unprofitable business), standards violations (which could be a bad operator or an aggressive franchisor if the number is high), etc. Requiring disclosure of the cause for termination may provide a lot of insight to prospective franchisees. This information is readily available to the franchisor can be provided at no additional cost.

The Coalition of Franchisee Associations appreciates this opportunity to provide input on changes needed the Franchise Rule. As the national trade association representing franchisees and franchisees only, we hope this is the beginning of the process to better enforce, evaluate and improve the Rule.

Sincerely,

John Motta
CFA Chairman

Misty Chally
CFA Executive Director

RESPONSE TO WRITTEN QUESTION OF SENATOR CORTEZ MASTO FROM OREN M. CASS

Franchise Loan Transparency Act

Q.1. At the hearing, my pending bill, the Franchise Loan Transparency Act was discussed, attached is proposed bill text and a short description of the bill. Please share with me your thoughts and concerns about the bill (See Appendix 1, pg. 85). If you can also note if you would recommend legislators support or oppose it, that would be helpful.

A.1. I have not studied the issue closely enough to offer an informed opinion about the bill.

RESPONSES TO WRITTEN QUESTION OF SENATOR SINEMA FROM OREN M. CASS

Q.1. Our country is in the longest period of economic expansion in U.S. history, with a reasonably strong labor market. Yet, wage growth continues to lag most economists' expectations. Why do you think that is?

A.1. Standard labor-market measures (*e.g.,* the unemployment rate) may not fully reflect the market's dynamics, for several reasons. One reason is that an unprecedented share of prime-age workers left the workforce in recent years and they are returning only gradually it is difficult to know how much slack remains. Another is that, in an era of globalization, the pool of labor to which employers have access is not necessarily bounded by the American market. In many cases, the option to move work overseas serves as a check on the pressure to raise domestic wages. The Nation's refusal to enforce its immigration laws likewise offers firms access to large pools of labor that are poorly captured in traditional data.

Q.2. According to recent reports, including the Federal Reserve's 2019 Consumer & Community Context report and Freddie Mac's June 2019 survey, fewer millennials are buying homes due to the rise in student loan debt. What kind of implications will a decline in home ownership by younger Americans have on the housing market?

A.2. It would be difficult to predict effects in the housing market without knowing more about consumer behaviors—for instance: Are they simply choosing to rent instead of buy? Are they reducing their expenditures on housing? Are they remaining in their parents' homes rather than forming new households? All those questions merit further study.

Q.3. We hear from small- and mid-sized employers that they cannot find individuals with the skills necessary to fill jobs. How do we encourage skills development and retention? How do we enable Americans to move to where good jobs are and succeed?

A.3. I would refer the Senator to my written testimony and accompanying report, "The Workforce-Training Grant: A New Bridge from High School to Career" (Manhattan Institute, July 2019), which describes the failures of our college-focused education system to provide most people with the skills they need to succeed in the labor market, and proposes an alternative in which employers rather than colleges play the leading role. I would also note that having Americans "move to where good jobs are" is neither a desirable nor likely outcome. People value the ability to reside near family and friends in the communities where they have built their lives and a well-functioning American economy would ensure that widespread prosperity reaches them in those places.

RESPONSE TO WRITTEN QUESTION OF SENATOR CORTEZ MASTO FROM RAMESH PONNURU

Franchise Loan Transparency Act

Q.1. At the hearing, my pending bill, the Franchise Loan Transparency Act was discussed, attached is proposed bill text and a short description of the bill (See Appendix 1, pg. 85). Please share with me your thoughts and concerns about the bill. If you can also note if you would recommend legislators support or oppose it, that would be helpful.

A.1. I have not studied this issue but commend the senator for calling attention to it. Before proceeding with Federal legislation, I would want to have a stronger sense that the problem is both large in scale and persisting at that scale (or growing in scale). If, for example, we are seeing increased transparency within the current regulatory environment, change to that environment may not be necessary. The potential costs of the proposed regulations would also be needed. Further study may thus be called for to determine whether regulatory change is required.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA FROM RAMESH PONNURU

Q.1. Our country is in the longest period of economic expansion in U.S. history, with a reasonably strong labor market. Yet, wage growth continues to lag most economists' expectations. Why do you think that is?

A.1. Some economists believe that as unemployment rates fall, wages should rise in some predictable way. But this belief is erroneous. Employee compensation, adjusted for inflation, has been growing roughly in line with productivity.

Q.2. According to recent reports, including the Federal Reserve's 2019 Consumer & Community Context report and Freddie Mac's June 2019 survey, fewer millennials are buying homes due to the rise in student loan debt. What kind of implications will a decline in home ownership by younger Americans have on the housing market?

A.2. Student-loan debt has likely played a role in reducing millennials' home ownership rate, but there are additional reasons for the generational decline in that rate. Millennials are also marrying later than previous generations and having smaller families (although the high price of housing may affect these decisions, and therefore the causal arrow points in both directions). In many cases, millennials began their working lives in a sharp recession and a slow recovery from it, which made it harder for many of them to save for a downpayment. Lending standards are also stricter than they were. Millennials have also disproportionately looked for housing in high-cost areas.

Some analysts have speculated that millennials place a lower value on home ownership than previous generations, seeing it for example as an inferior investment to stocks. To the extent such changes in preferences are reducing home ownership, the effect should be to make renting more expensive and housing less so, and policymakers should not be greatly concerned. To the extent that restrictive zoning laws and other public policies have reduced homeownership rates, on the other hand, they need to be revisited.

Q.3. We hear from small- and mid-sized employers that they cannot find individuals with the skills necessary to fill jobs. How do we encourage skills development and retention? How do we enable Americans to move to where good jobs are and succeed?

A.3. As my fellow witness Oren Cass has pointed out, about a sixth of young people follow the path our educational system seeks to put them on: earning a high-school diploma, enrolling in college, obtaining a college degree, and then getting a job that requires that degree. That fortunate fraction enjoys high lifetime earnings. The system needs to change to work better for the vast majority of Americans. In particular, we should expand vocational-education options involving employers.

As for matching workers and employers geographically: There is a natural incentive for people to move where they can earn higher wages. They must weigh them against their existing family and community ties, their desire to stay where they have been, and so forth. To the extent government policies make it harder for people to move, however, it impedes the healthful functioning of our labor market. Restrictive zoning laws, onerous and geographically varying occupational licensing requirements, and lack of portability in government benefits could all be changed in ways that make it easier for people to move where the jobs are. The government could also offer mobility grants, letting people take unemployment benefits in a lump sum in order to finance a move to a place where they can more readily find employment.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA FROM THEA M. LEE

Q.1. Our country is in the longest period of economic expansion in U.S. history, with a reasonably strong labor market. Yet, wage growth continues to lag most economists' expectations. Why do you think that is?

A.1. It is true that nominal wage growth is relatively lackluster, especially considering that unemployment has been below 4 percent for a year and a half, and we are 10 years into an economic recovery. In our view, there is no single cause, but a cumulation of factors over several decades.

Josh Bivens, EPI research director, wrote: "This failure of wages to get in gear should tell us three things: (1) there remains room for unemployment to fall even further (*https://www.epi.org/blog/the-fed-shouldnt-give-up-on-restoring-labors-share-of-income-and-measure-it-correctly/*);*[1]* (2) policy and labor market institutions have been turned decisively *against* (*https://www.epi.org/publication/what-labor-market-changes-have-generated-inequality-and-wage-suppression-employer-power-is-significant-but-largely-constant-whereas-workers-power-has-been-eroded-by-policy-actions/*) most workers' ability to bargain effectively for wage increases;*[2]* and (3) if we don't reorient these policies and institutions to support wage growth, workers will have to rely solely on high-pressure labor markets to see raises in the future—but these high-pressure labor markets have been the exception and not the rule (*https://www.epi.org/publication/the-importance-of-locking-in-full-employment-for-the-long-haul/*) for most of the time in recent decades.*[3]*"

[1] *https://www.epi.org/publication/labor-day-2019-macropolicy/#__note2.*
[2] *https://www.epi.org/publication/labor-day-2019-macropolicy/#__note3.*
[3] *https://www.epi.org/publication/labor-day-2019-macropolicy#__note4.*

It is no coincidence that this is the longest period in U.S. history without an increase in the Federal minimum wage, which is now worth 17 percent less than it was 10 years ago—and 31 percent less than in 1968.

Another major concern is the decline in manufacturing employment over the last 40 years, which has traditionally been the sector of the economy that pays relatively high wages to the noncollege-educated workers who still make up a large majority of the U.S. workforce. The workforce has shifted toward the service industry. In addition, growing trade deficits have cost the United States 5 million manufacturing jobs in the last two decades. EPI research indicates that manufacturing jobs offer total compensation that is 15 percent higher than the nonmanufacturing sector. The evidence over the same period suggests that there is a widening gap between the wages earned by those with higher education and those without. One important step we can take toward getting the trade balance back on track is to rebalance trade by realigning the dollar.

The decline in union membership has also had a negative effect on the pay and benefits of both union and nonunion workers. The share of workers covered by a collective bargaining agreement dropped from 27.0 percent to 11.7 percent between 1979 and 2018, meaning the union coverage rate is now less than half where it was 40 years ago. Without the right to collectively bargain, workers lack leverage to ask for better pay and benefits. It is also worth noting that people of color have historically benefited disproportionately from unionization. On average, a worker covered by a union contract earns 13.2 percent more than a peer with similar education, occupation, and experience in a nonunionized workplace in the same sector. One step legislators can take to sustain unionization is to support the Protect the Right to Organize (PRO) Act, which would make it easier for employees to collectively organize and bargain for better wages and benefits.

Q.2. According to recent reports, including the Federal Reserve's 2019 Consumer & Community Context report and Freddie Mac's June 2019 survey, fewer millennials are buying homes due to the rise in student loan debt. What kind of implications will a decline in home ownership by younger Americans have on the housing market?

A.2. The burden of student debt is an important reason that millennials may not be buying homes, but we also need to consider the fact that they have suffered from the post-recession job market. Due to their experience with the recession, individuals may also view home ownership as a risky asset. The combination of debt burden, a weak job market (in terms of real wages), and low home ownership rates will present challenges to the millennial generation and the economy in coming decades, as these factors will negatively impact wealth accumulation and retirement security.

Q.3. We hear from small- and mid-sized employers that they cannot find individuals with the skills necessary to fill jobs. How do we encourage skills development and retention? How do we enable Americans to move to where good jobs are and succeed?

A.3. On average, American workers have more education and more skills than past generations. But it is also true that the U.S. Government spends less (as a percentage of GDP) on workforce development and training than other wealthy industrialized countries, and the private sector does not compensate. According to the National Skills Coalition, "The U.S. invests just .1 percent of GDP on active labor market policies, less than any other industrialized country except for Mexico. Australia invests 24 times that amount, and Ireland invests 48 times that amount. At the same time, the United States has the largest economy in the world and more than 160 million workers in the workforce." And Government spending on workforce programs has plummeted in recent years, with the Workforce Innovation and Opportunity Act (WIOA) spending cut almost in half since FY2001.

Yet there is little evidence of a genuine shortage of skilled workers. Evidence of a skills shortage would be unusually strong wage growth for workers with the targeted skills. If employers can't find the workers they need, they will offer higher wages to attract needed workers from other firms, who will then raise wages in an attempt to keep their employees, and so on. Therefore, if a skills gap were the problem, we would expect to see faster wage growth. Instead, wage growth for many skilled workers has been relatively flat over much of the last year, despite low unemployment rates. For example, computer and mathematical science occupations, which are often cited in conversations about skills shortages, have a low unemployment rate, at 2.3 percent, but have also seen very low real wage growth, at less than 1 percent in 2018.

One reason that firms are not raising wages, as one would expect, is monopsony power. Monopsony occurs when there are a limited number of employers offering skilled jobs in a given area. So, when a firm with the power to set wages at a low rate complains about not being able to find workers at the wages they are offering, it's useful to remember that they are choosing to keep wages low in order to increase profits. Under such conditions, legislated interventions for wage increases can lead to increases in employment, in addition to benefiting individual workers.

But even in the absence of a skills shortage, there is no question that both workers and employers benefit from high-quality, well-designed and targeted training and apprenticeship programs, ideally with a strong union partner. These programs should be fully funded and focused on underserved communities and evolving technologies.

Works Consulted

Bivens, Josh, and Heidi Sheirholz. "Fair Competition in Labor Markets Requires a Politician's Thumb on the Workers Side of the Scale." "Unrigging the Market: Convening to Restore Competitive Labor Markets" Hosted by the Harvard Labor and Worklife Program, June 4, 2018. Accessed August 5, 2019. *https://lwp.law.harvard.edu/files/lwp/files/webpage__materials__papers__bivens__shierholz__june__13 __2018.pdf.*

Gould, Elise. "Job Growth Stays Solid but Wages Disappoint—again." Economic Policy Institute (blog), August 2, 2019. Accessed August 5, 2019. *https://www.epi.org/press/job-growth-stays-solid-but-wages-disappoint-again/.*

National Skills Coalition: *https://www.nationalskillscoalition.org/federalpolicy/body/CIAW-Invest-in-AW.pdf.*

"Nominal Wage Tracker." Economic Policy Institute, 2 Aug. 2019, *www.epi.org/nominal-wage-tracker/.*

Schmitt, John, Josh Bivens, and Elise Gould. America's Slow-Motion Wage Crisis. Report. September 13, 2018. Accessed August 5, 2019. *https://www.epi.org/publication/americas-slow-motion-wage-crisis-four-decades-of-slow-and-unequal-growth-2/.*

Scott, Robert. "The State of American Manufacturing." Economic Policy Institute, February 5, 2019. Accessed August 5, 2019. *https://www.epi.org/blog/the-state-of-american-manufacturing-the-failure-of-trumps-trade-and-economic-policies/.*

Shierholz, Heidi, and Elise Gould. "Why Is Real Wage Growth Anemic? It's Not Because of a Skills Shortage." Economic Policy Institute. July 19, 2018. Accessed August 5, 2019. *https://www.epi.org/blog/why-is-real-wage-growth-anemic-its-not-because-of-a-skills-shortage/.*

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA FROM KEITH R. MILLER

Senator, thank you for your questions, and the opportunity to provide my answers. As I stated at the hearing, my expertise is within the franchise industry, and how that relates to, realizing the American Dream. For me, it was important in my testimony to not only discuss the issues but give real life challenges franchise owners have seen. The franchise industry should be the model for those seeking the American Dream, and I wish to see improvements in the industry to make that hold true.

Q.1. Our country is in the longest period of economic expansion in U.S. history, with a reasonably strong labor market. Yet, wage growth continues to lag most economists' expectations. Why do you think that is?

A.1. Much of the labor growth in employment numbers come from the continued growth in the number of businesses open, this is especially true in the franchise industry, and even more true in the quick service restaurant (QSR) industry. This growth has far outpaced population growth. This fact means the pie is being cut into more pieces, so the competition to draw that population into the outlets is extreme, often using deep discounting, which may keep the revenue moving, but squeezing the profit margins of the outlet. Being a Subway franchise owner, I have seen this first-hand. The franchised brands in the QSR space have continued to push deep discounting. The impact, with the added units in the total system, has often seen the franchise company see increased profits, but the local franchisees squeezed tighter on margins than ever. You have to remember that it is these local franchisees that are the employers of the masses, not the franchise company. Most of us employers would like to pay higher wages to attract and retain employees, but simply, we have to make the business model work for us, which is a real challenge. I just don't think the industry has realized that its sustainability long-term, is the more balanced distribution of the monies in the business, from the franchise company, to the franchise owners, to the employees.

Q.2. According to recent reports, including the Federal Reserve's 2019 Consumer & Community Context report and Freddie Mac's June 2019 survey, fewer millennials are buying homes due to the rise in student loan debt. What kind of implications will a decline in home ownership by younger Americans have on the housing market?

A.2. Well, this is probably not a question that goes to my area of expertise, but I'll give my thoughts, tying it closer to my expertise areas. The costs of education, as we know, have skyrocketed, and creating a level of student debt never seen before. On top of that, the so-called good jobs for graduates seem to be centered in high cost housing markets. In many of these markets, even well-paying jobs have no chance of success in affording a home. I think the implications are widespread, and not just on the housing market. One point to remember is that many real estate firms operate under a franchise flag. With less buyers, there will be less business, creating a strain on the franchise owner. I think the big concern here is that after finishing their education, many of these students are unable to find jobs in an affordable area and are saddled with debt and tight budgets. These tight budgets make them even less likely afford normal spending, which drives many of the franchised businesses. The high costs of education and resulting debt are far reaching.

Q.3. We hear from small- and mid-sized employers that they cannot find individuals with the skills necessary to fill jobs. How do we encourage skills development and retention? How do we enable Americans to move to where good jobs are and succeed?

A.3. The statement is correct that we cannot find enough individuals. There is a critical labor shortage. Franchised business can be split into two, those that require skilled positions, and those that need little in skills. For businesses like automotive repair, for example, it seems few are being taught the trades. In the push for higher education, the trade skills seem to be lost. For many, avoiding the high cost of education and learning a trade is likely better financial decision, but we need to add more emphasis on that, and remove the stigma that not attending college is bad. For businesses that need untrained staff, and can train them, there are a few problems. As mentioned above, due to the tight business model margins, we often lose our best employees quickly to better paying jobs, like the banking industry. If we had the margins to pay better, that would help. However, I think we can do a much better job assisting our lower skilled employees in attaining better financial situations. It's an odd situation, but one I have heard repeated, that as wages increase (remember, I am in California which is a higher wage State), many that are on government assistance can start to make too much and start to lose their assistance. To the employer, it means the employee asks to make the same total pay, reducing hours, which means the need to hire more employees to satisfy the same total labor requirement. In a tight labor market, that is tough. We seem to have created systems with a ceiling, and I think both business and government can do better to help people bust through that ceiling. From a business standpoint, we can have mentorship programs and certification programs that teach these employees real skills that can later be used and transferred to better jobs, more mobility. If the starting, lower-paying jobs, were viewed in that light, the reluctance to work in them would be lessened. From the governments point of view, the ceilings on earnings for assistance need to be adjusted and sliding. It should never be a good result for someone to ask for less earnings than their potential, it really benefits no one.

Appendix 1. Franchise Loan Transparency Act (Draft)

MIR19159 S.L.C.

116TH CONGRESS
1ST SESSION

S. ____

To establish minimum standards of disclosure by franchises whose franchisees use loans guaranteed by the Small Business Administration.

IN THE SENATE OF THE UNITED STATES

Ms. CORTEZ MASTO introduced the following bill; which was read twice and referred to the Committee on

---

A BILL

To establish minimum standards of disclosure by franchises whose franchisees use loans guaranteed by the Small Business Administration.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Administration Franchise Loan Transparency Act of 2019".

SEC. 2. FINDINGS; PURPOSE.

(a) FINDINGS.—Congress finds that—

(1) franchise businesses represent a large and growing segment of the retail and service businesses of the United States and are rapidly replacing more

traditional forms of small business ownership in the economy of the United States;

(2) the Small Business Administration guarantees much of the financing available in franchising;

(3) the Small Business Administration requires pro forma projections, including projected revenue, for the first year of operations of a franchise as part of the standard operating requirements for a franchisee to qualify for financing;

(4) on July 13, 2011, the Office of Inspector General of the Small Business Administration published an audit (Report No. 11–16) on loans made under section 7(a) of the Small Business Act (15 U.S.C. 636(a)) (in this section referred to as "7(a) loans") to Huntington Learning Center franchises where first year revenue projections were all significantly inflated;

(5) on July 2, 2013, the Office of Inspector General of the Small Business Administration published an audit evaluation (Report No. 13–17) showing that the Administration needed to improve the management of the 7(a) loan portfolio risk, specifically with certain franchise brands that had exceptionally high default rates that continued to receive guaranteed loans from the Administration;

(6) in September 2013, the Government Accountability Office published a study (GAO–13–759) showing that over the 10-year period from 2003 to 2012, 28 percent of 7(a) loans provided to franchises required a guarantee payment;

(7) the study described in paragraph (6) was based on 32,323 loans totaling $10,600,000,000, which required $1,500,000,000 in guarantee payments;

(8) the report for the study described in paragraph (6) stated, "Potential franchisees should include first-year revenue estimates in their SBA loan applications. However, this information is not necessarily available to potential franchisees in the franchise organization's disclosure document.";

(9) franchise companies most often collect royalties based on gross revenue, therefore revenue data on each franchise outlet are readily available; and

(10) while both the franchisor and the lender profit as a result of financing from the Small Business Administration, the total liability for the loan is born by the franchisee.

(b) PURPOSE.—The purposes of this Act are to—

(1) ensure transparency in the loan processes of the Small Business Administration so that the

franchisee borrower, the lender, and the Administration all have access to information that is key to the lending process;

(2) lower the fees and rates charged to franchisee borrowers; and

(3) help ensure lower default rates in order to make more money available for loans to viable franchise brands.

SEC. 3. DEFINITIONS.

In this Act—

(1) the term "disclosure document" means the disclosure document required to be furnished by a franchisor to a prospective franchisee under section 436.2 of title 16, Code of Federal Regulations, as in effect on July 1, 2007;

(2) the term "Financial Performance Representation Commentary" means the Financial Performance Representation Commentary adopted by the North American Securities Administrators Association on May 8, 2017; and

(3) the terms "franchise", "franchisee", and "franchisor" have the meanings given those terms in section 436.1 of title 16, Code of Federal Regulations, as in effect on July 1, 2007.

SEC. 4. REQUIRED DISCLOSURES.

(a) IN GENERAL.—Subject to subsection (b), a franchisor, except for a franchisor of a franchise in the lodging industry, that qualifies for guaranteed lending from the Small Business Administration for the franchises of the franchisor shall, at a minimum, disclose in the disclosure document required to be furnished by the franchisor to any prospective franchisee the following information for each of the 3 years preceding the date of the disclosure document:

(1) The average and median first-year revenues for all businesses operated under franchises granted by the franchisor, in accordance with the Financial Performance Representation Commentary.

(2) The total number of businesses operated under franchises granted by the franchisor that, during the first year of operation, either—

(A) ceased operations; or

(B) were transferred to a new franchisee.

(3) The average and median revenues for all businesses operated under franchises granted by the franchisor, in accordance with the Financial Performance Representation Commentary.

(b) LIMITATION.—A franchisor may not disclose to a prospective or current franchisee, directly or through a third party, any information relating to revenue that conflicts with the information relating to revenue provided under subsection (a) in a disclosure document unless the relevant franchise purchase includes 1 or more businesses under the relevant franchise that are in existence on the date on which the disclosure is made, in which case the franchisor shall disclose to the prospective or current franchisee the relevant information relating to revenue as of the date on which the disclosure is made with respect to those businesses.

SEC. 5. ENFORCEMENT.

The Administrator of the Small Business Administration—

(1) shall enforce the requirements under this Act; and

(2) may hold a franchisor liable for the balance of any loan obtained through a violation of this Act.

SEC. 6. NO PREEMPTION.

Nothing contained in this Act shall prohibit an authorized State official from proceeding in State court on the basis of an alleged violation of any civil or criminal statute of that State.

SEC. 7. SEVERABILITY.

If any provision of this Act or any application of this Act to any person or circumstances is held invalid, the remainder of this Act and its application to any person or circumstance shall not be affected thereby.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

http://www.bloomberg.com/news/articles/2015-05-14/franchise-loans-keep-blowing-up-and-the-government-keeps-backing-them

Franchise Loans Keep Blowing Up, and the Government Keeps Backing Them

Nearly 20 percent get charged off by the SBA. Guess who pays

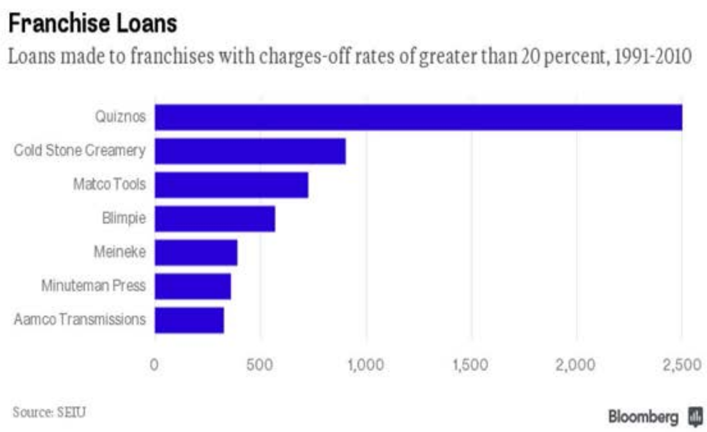
by Patrick Clark Bloomberg May 14, 2015 — 12:03 PM EDT

Buying a franchise is a risky business. Seventeen percent of franchise loans guaranteed by the U.S. Small Business Administration failed from 1991 to 2010, new data show. At the end of the period, almost one in five franchise owners went splat.

The loans, made by private lenders, weren't merely delinquent. Failed loans are those charged off by the SBA, which guarantees as much as 85 percent of the value of working-capital loans through its 7(a) program. Even after liquidating collateral, which can include franchise owners' homes, the government had to use taxpayer dollars to make the lenders whole.

Some franchises are worse bets than others. Meineke (22 percent), Quiznos (25 percent), and Huntington Learning Center (31 percent) had some of the highest failure rates among well-known brands.

So yes, running a business is harder than franchisors sometimes make it sound. Beyond that headline finding, the report is interesting for a couple of reasons.



First, it was compiled by the Service Employees International Union, the labor group that's been fighting to raise pay for fast-food workers. That campaign would seem to put the SEIU in opposition to franchise owners, who are at least nominally responsible for setting wages. Increasingly, however, the union has been aligning itself with those franchisees, on the theory that corporate franchise systems wield a lot of influence over store owners' budgets.

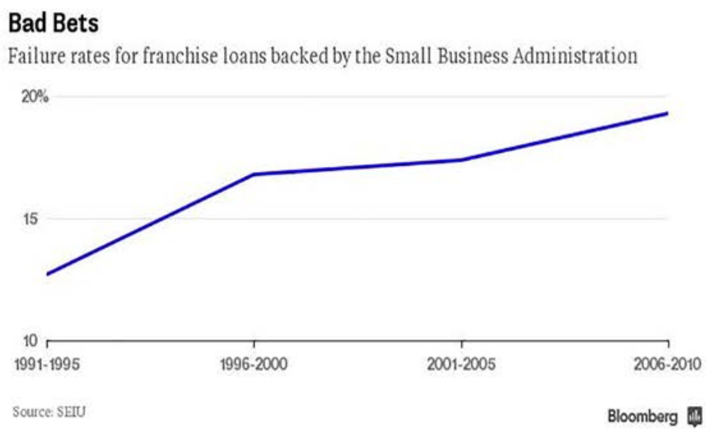
"We believe the high failure rate is due to a severe imbalance of power between franchisees and franchisors that contributes to a system of too many unstable businesses and low-wage work in the franchised fast-food sector," says Tia Orr, senior legislative director of the SEIU California State Council.

The union ended its analysis in 2010 because newer loans have had less time to go bad, making them difficult to compare with older loans. It consolidated the findings into five-year periods to smooth out spikes in failure rates, which were particularly dramatic during the recent recession. Data provided to Bloomberg by the SBA show that working-capital loans to franchises haven't performed as well as loans to nonfranchise businesses:

John Reynolds, president of the International Franchise Association Educational Foundation, says the union was "cherry-picking" data, and that the focus should be on the tens of thousands of franchisees who used SBA loans to successfully expand their businesses and add jobs to the U.S. economy. "I think [the SEIU] have an agenda that's focused around casting doubt or criticism on the fundamentals of the franchise model," he says.

Loan failure rates for individual franchise systems are hard to obtain, even though they could be useful to entrepreneurs deciding whether to invest in a franchise system. The union filed a Freedom of Information Act request to get its hands on the data. A recent paper co-authored by the SBA's chief franchise counsel, Stephen Olear, said that "franchisors who do not provide financial performance representations to prospective franchisees but want to provide information to prospective lenders, or who wish to provide additional information to these lenders, are free to do so."

When statistics do see the light of day, the numbers are often scary.



Why does the government keep guaranteeing these loans? The agency has argued that banks tend to stop approving loans for struggling franchises and that franchise failure rates are similar to failure rates for the overall lending program.

Yet failing franchises often continue selling new units. Over the last five years, the bottom 25 percent of franchise systems have opened more than 42,000 new outlets, according to Jeff Lefler, chief executive officer of research firm FranchiseGrade.

"On one hand, franchisees aren't doing enough due diligence," Lefler says. "On the other, unhealthy systems are marketing themselves loudly and aggressively to franchisees."

Correction: A previous version of this article mislabeled the first chart as representing the number of failed loans for the franchise chains listed. The chart properly represents the number of total loans issued for those chains, all of which had failure rates of greater than 20 percent.

Pit Owners' Association
PO Box 317
Milford, OH 45150

July 30, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The Pit Owners' Association ("POA") is an independent association of Dickey's Barbecue Pit® franchisees. Thank you for your ongoing efforts to address issues of concern to franchise owners. This letter serves as the POA's formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. We believe all franchisees, before they decide to buy a franchise, deserve to receive financial disclosures from their prospective franchisor, especially when obtaining government guaranteed loans which put all of their assets at risk. The Small Business Administration Franchise Loan Transparency Act of 2019 would, we believe, make great improvements to the disclosure information these prospective franchisees receive.

We look forward to seeing this important legislation become law and to and supporting your efforts.

Sincerely,

Pit Owners' Association

MaineFranchise
OwnersAssociation
Investors in Maine's Economy

July 25, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The Maine Franchise Owners Association (MFOA) represents franchise owners throughout Maine, the franchise investors in State's economy. We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Ed Wolak

Ed Wolak
Chair, Maine Franchise Owners Association

Meineke Dealers Association
PO Box 501448
San Diego, CA 92150-1448
Office Fax: 866-405-1625
Office Phone: 619-519-7694
Website: www.meinekedealers.com

July 30, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The Meineke Dealers Association (MDA) is the independent voice of Meineke Car Care Center franchisees. We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Randy Dubois

Randy Dubois

President, Meineke Dealers Association

July 30, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The North American Association of Subway Franchisees is the independent voice of the Subway® franchisee community. We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

The 2019 NAASF Board of Directors

National Coalition of Associations of 7-Eleven Franchisees

July 29, 2019

Senator Catherine Cortez Masto

516 Hart Senate Office Building

Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The National Coalition of Associations of 7-Eleven Franchisees (NCASEF) is an independent trade association for 7-Eleven franchisees nationwide. It is NCASEF's goal to represent the interests of franchisees to all parties, and to provide a forum for the exchange of information among franchisees, management, and our vendor partners.

Originally founded in 1973 by 6 franchisees, NCASEF today consists of 42 Franchise Owners Associations (FOAs), located in more than 30 states where 7-Eleven does business. Each regional FOA represents between 15 and 400 7-Eleven franchisee members who pay dues to their local association, and a portion of these dues supports National Coalition activities.

We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.

While we understand today that our brand does not qualify for SBA loans, this legislation is still important for the entire industry to take the steps to more complete disclosure. We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Jatinder Singh,

Chairman, National Coalition of Associations of 7-Eleven Franchisees

1001 Pat Booker Rd Suite 206 Universal City, TX 78148 Office: 210-971-9211 Fax: 210-971-9213
E-mail: nationaloffice@NCASEF.com Website: www.NCASEF.com

American Association of Franchisees & Dealers
The Center for Total Quality Franchising

P. O. Box 10158
Palm Desert, CA 92255-1058
(619) 209-3775
Direct Line: 619-649-0748
Fax: 866-855-1988
E-mail: rpurvin@aafd.org
Website: www.AAFD.org

July 30, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto:

The American Association of Franchisees and Dealers (AAFD) is a national non-profit trade association that has supported franchisee interests since our inception in 1992. We recognize and appreciate your continued support of franchise owner issues.

This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Robert L. Purvin, Jr.

Robert L. Purvin, Jr,
Chair, Board of Trustees

Congress of the United States
Washington, DC 20515

April 18, 2019

The Honorable Joseph Simons
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington DC 20580

Dear Chairman Simons:

We are writing regarding the February 14, 2019, request for public comment made by the Federal Trade Commission (FTC) regarding its decennial review of the FTC Franchise Rule. As you may be aware, the FTC has put forth thirteen questions to assess the efficiency, cost, benefits, and regulatory impact of the rule. Since the development of the first Franchise Rule promulgated in 1978, the rule has been one of the most important laws for the franchise sector. The FTC Franchise Rule was updated more than a decade ago following a 10-year-long, constructive, consensus-based process jointly led by franchisors and franchisees that delivers clear guidelines for franchisors to follow and transparent information for prospective franchise owners to do their due diligence before making an investment. That process worked, and the current FTC rule has led to a growing franchise economy with more than 733,000 locations who together employ nearly 8 million Americans. In the last decade, franchises have grown at nearly twice the rate of non-franchise businesses.

The current rule requires franchisors to provide all potential franchisees with a Franchise Disclosure Document (FDD) containing 23 specific items of information about the offered franchise, its officers, and other franchisees. The Rule discloses prospective purchasers of franchises transparent information on risks and benefits of such an investment. The material contained in the FDD is crucial to understanding the health and financial wellbeing of the franchise system. Furthermore, the health of any franchise system is dependent upon franchisees who understand the terms contained in the license agreement. By requiring clear and consistent disclosure of information at the outset of all franchise relationships, and through its evenhanded federal application, the existing rule allows for better-performing franchise brands and franchise business owners to succeed together.

The franchise community has consistently supported regulatory policies designed to ensure that prospective franchisees receive relevant information about their proposed franchise purchase sufficiently in advance of their purchase to permit them to make an informed and unpressured purchase decision. The current rule supports a proper balance between the legitimate disclosure needs of prospective franchisees and the compliance burdens and costs, borne by both franchisors and franchisees, such that a disclosure inevitably requires. The current rule has created a more efficient franchising system, where expectations are clear, rules are transparent, and all systems are required to comply with its requirements.

For these reasons, we strongly affirm a continuing need for the rule, which represents the franchise sector's interests and desire for thoughtful, fair regulation.

Sincerely,

Tony Cárdenas
Tony Cárdenas
Member of Congress

Gus M. Bilirakis
Member of Congress

Henry C. "Hank" Johnson, Jr.
Member of Congress

Jeff Van Drew
Member of Congress

Julia Brownley
Member of Congress

Henry Cuellar
Member of Congress

Bill Foster
Member of Congress

Denny Heck
Member of Congress

Mark Walker
Member of Congress

David P. Roe, M.D.
Member of Congress

Denver Riggleman
Member of Congress

Kurt Schrader
Member of Congress

Raja Krishnamoorthi Member of Congress	Vicente Gonzalez Member of Congress
Dan Kildee Member of Congress	Steve Watkins Member of Congress
Daniel P. Meuser Member of Congress	Tom O'Halleran Member of Congress

INTERNATIONAL FRANCHISE ASSOCIATION
FRANCHISING
Building local businesses, one opportunity at a time.

July 24, 2019

The Honorable Tom Cotton
Chair, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

The Honorable Catherine Cortez Masto
Ranking Member, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

Dear Chairman Cotton, Ranking Member Cortez Masto, and Subcommittee Members:

On behalf of the International Franchise Association (IFA), I would like to thank you for convening the July 17, 2019, hearing titled "Economic Mobility: Is the American Dream in Crisis?" While the role of franchising in America was emphasized during the hearing, the perspective shared is not illustrative of the positive benefit the franchise business model provides to small business entrepreneurs and their employees across the country. Much of the discussion surrounding franchising simply ignored or misconstrued how current federal and state laws govern both franchise disclosures *and* the SBA lending process. Furthermore, the discussion cherry-picked outdated and extreme examples rather than holistically examining the largely healthy and iterative relationships that exist between franchisees and franchisors. IFA would like to offer our association as a resource and deliberative partner as the Subcommittee continues to examine the regulation and role of franchising in America.

IFA is the world's oldest and largest organization representing franchising worldwide. The association collectively represents the franchising business model, including franchisor brands, locally-owned small business franchisees, and the network of businesses that contribute to the business model. Specifically, IFA members include more than 1,300 member franchise companies in more than 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, and business development.

As an association dedicated to excellence in education and advocacy, we take seriously our members' desire for consensus-based policymaking. Our association's mission is to "protect, promote, and enhance franchising" in order to ensure the small business model is accessible to persons of all identities, backgrounds, and beliefs. We take pride in the diversity of franchising, as 30% of franchise businesses are minority-owned, compared to less than 20% of non-franchised businesses. We also take pride in promoting the economic impact of more than 733,000 franchise establishments, which support nearly 7.6 million jobs and $674.3 billion of economic output for the U.S. economy.

IFA and its many members have, over the years, collaborated with public officials domestically and internationally to shape the laws and policies that govern franchising, with the goal of promoting franchise growth and protecting the critical interests of both franchisees and franchisors. As IFA's nearly 60-year record of accomplishments amply demonstrates, IFA has consistently supported regulatory policies designed to ensure that prospective franchisees receive relevant and material information about their proposed franchise purchases sufficiently in advance of such purchases to enable them to make informed and unpressured purchase decisions.

The United States Federal Trade Commission (FTC) enacted the Federal Franchise Rule in 1979; it has since been refined and amended, most recently in 2008, to provide strict guidelines and definitions around what constitutes a business format franchise. The FTC's Franchise Rule established three criteria that have been defined and enforced by the federal agency, state regulators, and court systems on both the federal and state levels. Franchises are strictly creatures of statute and are regulated as such only if they fit the statutory definition. The primary purpose of the Franchise Rule is to provide prospective franchisees the material information they need to weigh the risks and benefits of purchasing a franchise. That material information is conveyed via the Rule's requirement to provide a Franchise Disclosure Document (FDD), which includes 23 specific items of information about the franchisor, the franchise business, its franchisees, and the terms of the franchise agreement. Since its development, the Rule has been one of the most, if not the most, important laws for the franchise sector.

The FTC Franchise Rule was updated more than a decade ago following a 10-year-long, constructive, consensus-based process jointly led by franchisors and franchisees. That process worked, and the current FTC rule has led to a growing franchise economy with more than 733,000 locations who together employ nearly 8 million Americans. In March 2019, the FTC opened for comment its 10-year, systematic review of the Franchise Rule, requesting public comment on the efficiency, costs, benefits, and regulatory impact of the Rule. After forming an internal membership Task Force to guide IFA's position, IFA submitted the attached regulatory comments, which emphasized the need to continue the Rule. The Rule has created a more efficient franchising system, where expectations are clear, rules are clear, and all systems are obligated to comply with its requirements.

IFA strongly believes that the current Rule supports a proper balance between the legitimate disclosure needs of prospective franchisees and the compliance burdens and costs, borne by both franchisors and franchisees, such that a disclosure inevitably requires. Eighteen bipartisan Members of Congress, led by Reps. Tony Cardenas and Gus Bilirakis, agree with the association, echoing the need for a continuation of regulatory oversight over the business model.[1] Notably, IFA further urged the FTC to continue the Rule, expressing a concern that the Franchise Rule could be at risk of elimination or material change under Executive Order 13771, "Reducing Regulation and Controlling Regulatory Costs." We also highlight that the association has encouraged the FTC to consider some mechanism, short of an additional rulemaking, that would permit the FTC to implement evolutionary, rather than revolutionary changes, in the disclosure process. This is consistent with the association's interest in developing consensus-based policymaking, as we welcome participation in any such further discussions that the FTC might propose.

The positive role played by the Rule and its success as a behavior-changing directive are apparent from the significant growth in franchising over the years and, most importantly, the high degree of franchisee satisfaction. Over the past 10-plus years since the Rule was last amended, the number of business-format franchised units has skyrocketed 16% from 381,890 outlets to 441,300 outlets.[2] Most importantly, franchisee satisfaction is at an all-time high.

According to research conducted by Franchise Business Review,[3] whose results were publicly released on April 18, 2019, 88% of franchise owners surveyed indicated that they "enjoy operating their business," and 87% said they "enjoy being part of their franchise organization."[4] With respect to the future outlook for their businesses, 67% rated their long-term growth opportunities as "very strong" or "strong." Only 8% rated their long-term growth opportunity as "weak" or "very weak."[5] Franchise Business Review's current data is based on surveys from October 2017 through March 2019 of more than 29,300 franchisees representing 310 different franchise systems. Key drivers of franchisee satisfaction included training,

[1] See attached Congressional letter dated April 18, 2019.

[2] FRANdata 2019 franchise unit analysis. FRANdata is an independent research firm with the world's largest information and analyst resources dedicated to the franchise business model.

[3] Franchise Business Review is an independent market research firm that specializes in benchmarking franchisee satisfaction based exclusively on ratings and reviews from franchise owners.

[4]https://tour.franchisebusinessreview.com/press-release/record-high-satisfaction-franchise-business-owners/.

[5] *Id.*

marketing, technology, innovation, and franchisor-franchisee relations,[6] all of which are addressed to varying degrees in the current Rule disclosure framework.

The FTC Rule provides a standardized framework that drives both regulatory oversight and market discipline. The Rule was set up for regulatory oversight to come from individual states. All states have business laws. About a quarter of all states have specific franchise regulatory departments from which enforcement actions flow. Market discipline comes in two forms from the information in an FDD. First, there is considerable case law involving the franchise business model that has defined how the business model is executed. Second, the general availability of FDDs with their standardized reporting requirements and public scrutiny of brand performance have created competitive pressures for franchise brands because the market is watching how brands perform.

As an example, market forces have driven franchisors to provide increasing transparency into their systems' financial performance disclosures, with 66% of franchisors disclosing revenue information in their Item 19s in 2017, compared to only 52% in 2014. Furthermore, franchisors have improved the quality of their disclosures and the level of transparency into unit financial performance under the Rule's current framework. 47% of franchisors with an Item 19 disclose operating expenses, and 34% provide some measure of profitability, including operating income, net income, or earnings before income, taxes, depreciation, and amortization (EBITDA). Since 2014, almost half of franchisors have increased the sample basis of their reporting to include a larger portion of their franchised system, on average, representing 77% of their franchised system.[7]

These statistics reflect, unlike what was highlighted in the July 17th hearing, that the actual experiences of an overwhelming number of franchisees once they start operating their franchised businesses are consistent with their pre-investment expectations for those businesses—expectations created and nurtured in large measure by the FTC Franchise Rule-based disclosures they received.

The Small Business Administration (SBA) plays an equally important role to franchising as the FTC. Approximately 117,000 new small businesses opened between 2015 and 2017 through franchising and much of the financing was through SBA-guaranteed lending programs, including the 7(a) and 504 loan programs. It is an understatement to say that the role of the SBA in ensuring small business entrepreneurs can access these loans is essential.

Importantly, the SBA has important checks and balances to ensure that its loan guaranty programs are strong. On the front end of the lending process and starting on January 1, 2018, the SBA initiated a new Franchise Directory[8] and revised its requirements for franchisors to qualify their franchisees for SBA financing programs. Under the new process, a brand operating with an agreement that meets the FTC definition of a "franchise" is listed on the SBA Franchise Directory only if it has been found by SBA to meet SBA's "affiliation," "business eligibility," and "franchise" definitional requirements. If a franchise system is not on the SBA Franchise Directory, a franchisee's application for SBA financing cannot be processed. The mandatory identification of franchisee loan recipients provides data to SBA that is much more complete than prior to the process changes.[9] Further, the SBA's Office of Inspector General and Office of Advocacy have important roles to play in the oversight process.

---

[6] *Id.in*

[7] FRANdata 2017 Financial Performance Representation Study, April 2017.

[8] The SBA Franchise Directory can be accessed at www.sba.gov/for-lenders.

For the reasons set forth above, IFA stresses to the Subcommittee that the perspective shared during the July 17, 2019, hearing is not illustrative of the positive benefit the franchise business model provides to small business entrepreneurs and their employees across the country. IFA looks forward to continuing our discussions with the Subcommittee on these important issues, and we thank you again for considering our views.

Sincerely,

Matt Haller
Senior Vice President of Government Relations & Public Affairs
International Franchise Association

Honorable April J. Tabor
Acting Secretary
Federal Trade Commission
Office of the Secretary
Constitution Center
400 7th Street SW
5th Floor
Suite 5610 (Annex B)
Washington, D.C. 20024

Re: Franchise Rule Regulatory Review
16 CFR Part 436
Matter No. R511003

Dear Acting Secretary Tabor:

On behalf of the International Franchise Association ("IFA") and its members, we submit these comments in response to the Federal Trade Commission's ("FTC") request for public comment on its Trade Regulation Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising" (the "Rule"), published in the Federal Register on March 13, 2019 (84 Fed. Reg. 9051).

IFA is the world's oldest and largest organization representing franchising worldwide. Celebrating close to 60 years of excellence, education, and advocacy, IFA works through its government relations and public policy, media relations, and educational programs to protect, enhance, and promote franchising. Through its media awareness campaign highlighting the theme, "Franchising: Building Local Businesses, One Opportunity at a Time," IFA promotes the economic impact of more than 733,000 franchise establishments, which support nearly 7.6 million jobs and $674.3 billion of economic output for the U.S. economy.[1] Additionally, around 30% of franchise businesses are minority-owned, compared to less than 20% of non-franchised businesses.[2] IFA members include over 1,300 member franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in

---

[1] https://franchiseeconomy.com/files/Franchise_Business_Outlook_Jan_2018.pdf.
[2] https://www.franchise.org/sites/default/files/Franchise%20Business%20Ownership%202018_0.pdf.

marketing, law, and business development.

IFA and its many members have, over the years, collaborated with public officials domestically and internationally to shape the laws and policies that govern franchising, with the goal of promoting franchise growth and protecting the critical interests of both franchisees and franchisors. As IFA's nearly 60-year record of accomplishments amply demonstrates, IFA has consistently supported regulatory policies designed to ensure that prospective franchisees receive relevant and material information about their proposed franchise purchases sufficiently in advance of such purchases to enable them to make informed and unpressured purchase decisions. IFA also has supported a proper balance between the legitimate disclosure needs of prospective franchisees and the compliance burdens and costs—borne by both franchisors and franchisees—that such disclosure inevitably entails.

IFA actively participated in the deliberations leading to both promulgation of the Rule in 1978 and its modification in 2007, supporting the FTC's early initiatives in the disclosure area and then applauding the FTC's willingness to recalibrate the Rule's specific disclosure requirements 30 years later—based on detailed comments submitted by various stakeholders in franchising, including the IFA—to reflect numerous advancements in technology, new and emerging trends in modern-day franchising, and a shift in the information deemed relevant and material to prospective franchisees.

IFA once again wishes to share with the FTC its insight into the experiences of franchisors and franchisees with the disclosure regimen now in effect. The bottom line is that, in light of the unity of support communicated by its franchisee, franchisor, and supplier members, IFA strongly endorses continuation of the Rule in substantially its current format. From IFA's perspective, the Rule:

(1) accomplishes its principal objective of providing, through the Franchise Disclosure Document, relevant and material information to prospective franchisees throughout the United States about the particular franchise program and the cost and nature of the proposed investment in advance of their franchise-acquisition decisions;

(2) establishes predictable, transparent, and understandable processes with which both franchisors and franchisees have become familiar, which prospective franchisees have come to expect, and with which franchisors have become increasingly compliant;

(3) sets a minimum threshold that all franchisors must satisfy in order to bring their franchise programs to market, particularly when those franchisors are not based in or do not venture to the 15 states with franchise registration/disclosure laws;

(4) provides franchisees with benchmarks to analyze competing franchise opportunities; and

(5) minimizes the potential for franchisor misrepresentations at the expense of franchisees by compelling franchisors to establish a "record" of their franchise offering.

No matter the costs that franchisors incur to prepare a Rule-mandated Franchise Disclosure Document—which necessarily vary depending on the size, maturity, complexity, and sophistication of the particular franchise system—they are a small price to pay to ensure the flow of material information so essential for franchisees to make an informed business decision and, if desired, to compare different franchise opportunities available on the market. The absence or paucity of such information in the franchisee's decision-making process would, IFA believes, only lead to increased, unacceptable levels of uninformed and unwise business decisions, distrust, disappointment, unhappiness, investment losses, litigation, and additional government regulation, all of which would tarnish the reputation and integrity, and threaten the ever-growing economy- and life-enhancing benefits, of the franchise model itself. It is not hyperbole to suggest that a franchisor unable or unwilling to bear the costs of preparing and properly using a compliant Franchise Disclosure Document is probably not adequately prepared or sufficiently responsible to engage in franchising in the first place. And the reality is that franchisors wishing to offer and grant franchises in one of the 15 states with franchise registration/disclosure laws already must prepare a Franchise Disclosure Document. Therefore, retaining a disclosure requirement in the remaining 35 states does not meaningfully increase a franchisor's costs for legal compliance.

Indeed, if the FTC started down the path toward abolishing the Rule, we fully anticipate that the trend in the 1970s before the FTC adopted the Rule would resume—with more states adopting franchise disclosure and registration laws, some imposing different standards, and franchisors' compliance costs actually ballooning in order to meet those additional and disparate standards. Notably, former FTC Commissioner Terry Calvani memorably commented on the value of a consistent standard similar to the Rule when he observed that differing state laws might present a "crazy patchquilt" of regulation in the national economy. The impact of additional states adopting laws would be in addition to the likelihood that franchisors then would have to comply with existing state business opportunity laws that currently are not a compliance burden because they include built-in exemptions for franchisors that comply with the Rule.

The positive role played by the Rule and its success as a behavior-changing directive are apparent from the significant growth in franchising over the years and, most importantly, the high degree of franchisee satisfaction. Over the past 10-plus years since the Rule was last amended in

2007, the number of business-format franchised units has skyrocketed 16% from 381,890 outlets to 441,300 outlets.[3] Most importantly, franchisee satisfaction is at an all-time high.

According to research conducted by Franchise Business Review,[4] whose results were publicly released on April 18, 2019, 88% of franchise owners surveyed indicated that they "enjoy operating their business," and 87% said they "enjoy being part of their franchise organization."[5] With respect to the future outlook for their businesses, 67% rated their long-term growth opportunities as "very strong" or "strong." Only 8% rated their long-term growth opportunity as "weak" or "very weak."[6] Franchise Business Review's current data is based on surveys from October 2017 through March 2019 of over 29,300 franchisees representing 310 different franchise systems. Key drivers of franchisee satisfaction included training, marketing, technology, innovation, and franchisor-franchisee relations,[7] all of which are addressed to varying degrees in the current Rule disclosure framework.

Market forces have driven franchisors to provide increasing transparency into their systems' financial performance disclosures, with 66% of franchisors disclosing revenue information in their Item 19s in 2017 compared to only 52% in 2014. Furthermore, franchisors have improved the quality of their disclosures and the level of transparency into unit financial performance under the Rule's current framework. Forty-seven percent (47%) of franchisors with an Item 19 disclose operating expenses, and 34% provide some measure of profitability, including operating income, net income, or earnings before income, taxes, depreciation, and amortization (EBITDA). Since 2014, almost half

[3] FRANdata 2019 franchise unit analysis. FRANdata is an independent research firm with the world's largest information and analyst resources dedicated to the franchise business model.
[4] Franchise Business Review is an independent market research firm that specializes in benchmarking franchisee satisfaction based exclusively on ratings and reviews from franchise owners.
[5] https://tour.franchisebusinessreview.com/press-release/record-high-satisfaction-franchise-business-owners/.
[6] *Id.*

of franchisors have increased the sample basis of their reporting to include a larger portion of their franchised system, on average, representing 77% of their franchised system.[8]

These propitious statistics reflect, among other things, that the actual experiences of an overwhelming number of franchisees once they start operating their franchised businesses are consistent with their pre-investment expectations for those businesses—expectations created and nurtured in large measure by the Rule-based disclosures they received. Indeed, IFA's recent survey of its membership revealed almost unanimous support for the Rule and substantial support (roughly two-thirds of respondents) for no Rule changes at all.

The Rule-mandated Franchise Disclosure Document has become the virtual maypole of the franchising process. It has leveled the informational playing field for franchisees while generating few meaningful complaints from franchisors. Any material deviation from the current process would, IFA fears, set franchising back significantly.

Of course, there always is room for improvement if the FTC were to decide to massage certain aspects of the Rule to account for continuing technological advances and other developments since 2007. However, even as now written, the Rule should be treated as inviolate and essential to the continued growth and success of the franchise model. In order to maintain the utmost flexibility, IFA encourages the FTC to consider some mechanism (short of an additional rulemaking) that would permit the FTC to implement evolutionary rather than revolutionary changes in the disclosure process. IFA would be interested in participating in any such further discussions that the FTC might propose.

---

[7] *Id.*
[8] FRANdata 2017 Financial Performance Representation Study, April 2017.

Honorable April J. Tabor
April 24, 2019
Page 7

We hope that the foregoing comments are helpful and express our appreciation for the FTC's role in preserving a trade regulation rule that contributes to the well-being of an essential and vibrant segment of the United States economy.

Respectfully submitted,

Matthew A. Haller
Senior Vice President, Government Relations & Public Policy
International Franchise Association

INTERNATIONAL FRANCHISE ASSOCIATION | FRANCHISING® Building local businesses, one opportunity at a time.

July 24, 2019

The Honorable Tom Cotton
Chair, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

The Honorable Catherine Cortez Masto
Ranking Member, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

Statement on "Economic Mobility: Is the American Dream in Crisis?"

Submitted to the Senate Banking Committee Subcommittee on Economic Policy

Dear Chairman Cotton, Ranking Member Cortez Masto, and Subcommittee Members:

As the Chairman of the Board and the Chairman of the Franchisee Forum of the International Franchise Association (IFA), we appreciate the opportunity to comment for the record on how the franchise business model is a vehicle for achieving the American Dream. Leveraging our experience as successful franchise business owners and mentors to prospective franchisees, we would like to offer a more comprehensive picture of franchising than the one painted at the Subcommittee; share information that highlights the strength of the U.S. Small Business Administration (SBA) system for vetting franchise brands for loan approvals; and express our firm belief that participation in the franchise business industry helps unlock economic prosperity for all Americans.

As the representative body for franchisees within the IFA, we are proud to be a clarifying voice for franchisees as legislative and regulatory issues impacting the franchise business model arise at the federal, state, and local levels. The view on franchisee dissatisfaction offered at the Subcommittee hearing suffers from at least two flaws. First, while we support transparency and disclosure as required by the FTC Franchise Rule, the suggestion to require the FTC to collect and review every Franchise Disclosure Document (FDD) would be unnecessary, costly and burdensome to the agency. The Franchise Rule *already* requires every franchisee to receive this extensive document as part of the purchasing process, and adding this regulatory burden to the FTC will only add an additional and unnecessary task. Increasing regulations requiring an agency to collect thousands of FDDs will not improve prospective purchasers' willingness to carefully consider whether franchising is right for them and conduct due diligence of a franchise network. Both tasks are critical steps for individuals who wish to determine whether to make a franchise investment.

Second, the testimony does not include statistics for franchise business unit closures beyond the year 2014. Both the SBA statistics (2000-2011) and the Franchise Grade data (2010-2014) cited in the testimony include units that closed during the Great Recession. It weakens the argument to cherry-pick years when many American businesses – whether big or small, franchised or stand-alone – were struggling to survive.

In response to the call for increased Federal Trade Commission (FTC) disclosure of brands qualifying for SBA 7(a) loans, we acknowledge previous legislative efforts (H.R. 471, 115th Congress; H.R. 3559, 116th Congress) designed to achieve the same goal. We would respectfully point out that these bills did not receive committee action and lost congressional support between sessions of Congress.

It is also important to note that SBA-guaranteed lending programs are an important source of financing for small franchise business owners, many of whom are first-time entrepreneurs. In 2018, the SBA made

$5.6 billion worth of 7(a) loans to franchises. In order to even be pre-approved for SBA loan applications, franchise businesses must meet strict eligibility standards. Once approved, brands are listed on an in-house directory that lenders can rely on when deciding whether to extend SBA financing to franchisees.

Critically, no brand is available to a franchisee unless the brand is listed on this in-house directory. In addition, the SBA's electronic loan processing system for 7(a) lending (E-Tran), requires that lenders identify franchise loans as well as the specific franchise when entering a loan application. This requirement, which has been in place since late 2016, allows for more accurate data pertaining to 7(a) franchise loans. This robust system of oversight at the SBA highlights a story untold at the hearing: that it is simplistic to blame a handful of franchisee failures on the SBA when other factors must be assessed.

Without addressing and examining these additional considerations, it is irresponsible to conclude that a few bad apples represent the entire franchise industry. While there may be instances when a franchisor behaves or takes action that is perceived to be unjust to a franchisee or prospective franchisee, they are rare. We know first-hand that small business franchise ownership is a viable pathway to achieving and maintaining economic success. With careful planning and execution, sound management of a franchise business can help grow the business and the franchisor's brand – contributing to a successful relationship between the franchisee and the franchisor. Allowing someone who profits off the unfortunate circumstances of others to paint a one-sided picture of franchising does a disservice to the thousands of small franchise business owners in this country who work hard every day to grow their business and our economy.

The story about franchising we wish had been aired at the hearing is one based in data rather than anecdotes. For example, we are proud to represent a business model that attracts minority and veteran ownership. Data from a U.S. Census Bureau survey shows the minority ownership rate for franchised businesses increased from 20.5 percent in 2007 to 30.8 percent in 2012 (the most recent years for which data is available) – highlighting how franchising is increasing the number of opportunities for minorities to own their own business. In addition, since 2011, approximately 238,000 veterans and military spouses have found opportunities in the franchise industry and 6,500 veterans have become franchise business owners. Their lasting success in the franchise industry creates diversity within the broader franchise network and creates opportunities for others.

We thank the Subcommittee for its attention to our views.

Sincerely,

David Barr
Chairman, PMTD Restaurants
Chairman, International Franchise Association

Tom Baber
Money Mailer and IHOP Franchisee
Chairman, International Franchise Association Franchisee Forum

National
TUPSSO
Franchise Owners
Association

July 26, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

On behalf of our Member franchises across the country, we, The National TUPSSO Franchise Owners Association, thank you for your support of the Small Business Franchise Loan Transparency Act.

The National TUPSSO Franchise Owners Association independently represents more than 1,000 The UPS Store locations. All across the country, small business owners continue to embrace the entrepreneurial spirit of America by pursuing the possibility of opening their own franchise. It is critical that these prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

· Disclose first year average and median revenue for franchised outlets.

· Disclose first year ceased operations and transfers of franchised outlets.

· Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.

· Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Tad Mollnhauer

Tad Mollnhauer
Executive Director
The National TUPSSO Franchise Owners Association

National TUPSSO Franchise Owners Association

IAKF
Every Franchisee. One Voice.

July 26, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

The International Association of Kumon Franchisees is an independent association of Kumon Math and Reading Center owners. We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is **critical** that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Connie Schmidt Kirman

Connie Schmidt Kirman
Board Member, IAFK
Kumon Franchise Owner in Howell, NJ
kumonhowellnj@gmail.com
732-239-3999

July 24, 2019

Senator Catherine Cortez Masto
516 Hart Senate Office Building
Washington, DC 20510

Re: Endorsement of the SBA Franchise Loan Transparency Act

Dear Senator Cortez Masto,

Max Independent Franchise Owners Association (MaxIFOA, Inc.) is the independent voice of Max Muscle® franchisees. We recognize and appreciate your continued support of franchise owner issues. This letter serves as our formal endorsement of your Small Business Administration Franchise Loan Transparency Act of 2019. In making the decision to buy a franchise, it is critical that prospective franchise owners receive reliable disclosure information, especially when accessing government guaranteed loans that put all their assets at risk. This legislation will make great improvements to the disclosure information these prospective franchisees receive. The legislation will specifically require brands receiving SBA guaranteed loans to:

- Disclose first year average and median revenue for franchised outlets.
- Disclose first year ceased operations and transfers of franchised outlets.
- Prevent disclosure of financial performance representations by the franchisor or a third party outside of the required disclosure document.
- Hold the franchisor accountable for any SBA guaranteed loan where provided false disclosure has occurred.

We look forward to engaging our franchisees in the process of passing this important legislation and supporting your efforts.

Sincerely,

Mark Sarale
Chair, Max Independent Franchise Owners Association (MaxIFOA, Inc.)