

Viewpoint

Redirect tax policy to spur innovation, not to serve status quo

going to look the same as they did, exactly. But they're still going to be there.'

James P. Marks
Interim superintendent of diocesan schools, on declining enrollments in Catholic elementary and secondary schools in the Scranton Diocese.

'The days of parents just being grateful their children aren't in an institution are over.'

Tara McHale
President of the Lackawanna County Autism Coalition, claiming that the failure of local special education officials to listen to parents led to abuse charges against a teacher.

The August job report shed some light on our nation's economic health, and it is clear that the economy is faced with substantial challenges – not the least of which is replacing the nearly 3 million jobs shed since the beginning of 2001. Despite 11 months of job growth, the economy still has 1.2 million fewer new jobs than it did three years ago. Even more alarming is that one in every five unemployed people – 1.7 million American workers – has been out of work for more than 26 weeks, the maximum duration for receiving unemployment benefits. While periods of protracted unemployment are not uncommon, the lack of job creation is atypical.

Contributing to this phenomenon are the recent changes in the microstructure of the U.S. economy, including the adoption of productivity-enhancing technologies, which combined with trade policies encouraging the off-shoring of U.S. jobs, have fundamentally altered the competitive environment in which American businesses operate.

A recent Federal Reserve Bank of New York research paper suggests that such structural

changes may be contributing to the struggling labor market. Since many of these job losses are not temporary but permanent, the economy must create new industries that will contribute significantly to U.S. economic growth and employment opportunities in the future.

Early twentieth century economist Joseph Schumpeter, famous for his study of business cycles and entrepreneurial activity, referred to this phenomenon as "creative destructionism," an ongoing process in which new companies replace those that failed to evolve with the economy. Schumpeter argued that entrepreneurs, through their innovative ideas, actually propel economies forward and permit them to maintain their standing or even to reach new heights. Schumpeter's theories were readily apparent during the re-

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cession of the early 1990s as small businesses created approximately 3.8 million jobs, contributing greatly to the economy's recovery, while also laying the seeds for future economic growth.

The late 1990s wave of "creative destructionism" had its roots in the successful run of many dot-com firms. This wave continued following the disbanding of many of these startup firms as established companies began to embrace new technologies. While many companies formed during this period, recent job losses have far exceeded the gains of these new firms, calling into question the economy's ability to reinvent itself yet again and create the industries needed to lead America forward. Until a new wave of entrepreneurial activity commences, the U.S. economy will remain at a standstill.

While President Bush has certainly recognized the massive job losses resulting from these structural changes, his policy proposals have not been successful in stimulating the development of new industries and bringing new jobs to those sectors devastated by the economy's

trajectory. To spur the economy, the president has peddled a series of tax reduction measures, many of which have been enacted into law during the last three years. While tax policy certainly plays a critical role in encouraging investment, the president's tax reforms have largely served to preserve the corporate landscape, rather than redirect capital to new ideas and industries. And this is playing out in the economy, as established businesses' profits are reaching new heights, while venture capital investment and IPO activity have struggled to reach even one-fourth of their pre-2001 levels.

Unfortunately, the president's stubborn reliance on a failed, one-size-fits-all tax policy has been accompanied by a near complete withdrawal of resources for programs that spur innovation and entrepreneurship throughout the economy. The Bush administration's FY 2005 budget gutted nearly 40 entrepreneurial development programs, including those targeted at advancing domestic manufacturing, promoting technology innovation, spurring rural development, and providing seed capital to startups. Given the

variable nature of the private sector's tolerance for risk, these initiatives are essential to draw new entrepreneurs into the economy and strengthen those that are unable to fully access the marketplace's resources.

By only pursuing policies that maintain the economy's current structure and level of activity, rather than exciting our nation's entrepreneurial spirit, the president's policies serve only to impede our economy's ability to reinvent itself. As a result, the recent signs of economic resurgence may not reveal a new Golden Age, but instead, a return to even higher unemployment and economic stagnation.

At a time when the economy is struggling to regain its full strength and investor appetite for risk remains modest, America needs a visionary economic policy that will provide both resources and incentives that encourage innovation and the development of new ideas. It is only through such empowerment of entrepreneurs that our nation will be able to move forward and reach new heights.

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