TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business.®

Testimony of

Dr. William C. Dunkelberg,
NFIB Chief Economist

before the

Committee on the Budget

on the subject of

Private Sector Growth and the Economy

on the date of

May 3, 2017

Good morning Chairman Enzi, Ranking Member Sanders and members of the Committee on the Budget. Thank you for this opportunity to testify today on "Private Sector Growth and the Economy".

My name is Bill Dunkelberg and I serve as the Chief Economist of the National Federation of Independent Business. NFIB is the nation's leading small business advocacy association, representing members in Washington, D.C. and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses.

Small businesses are the bedrock of the U.S. economy with roughly 28 million small firms, of which about 5.7 million are small employers.[1] Small businesses account for about half of private U.S. gross domestic product and about half of the private sector employment. Their contribution to the U.S. economy is vital to the creation of a strong foundation for the middle class, offering job opportunities and contributing to its local communities. Small businesses provide goods and services in every market, in every geographic region, and throughout every demographic across the country.

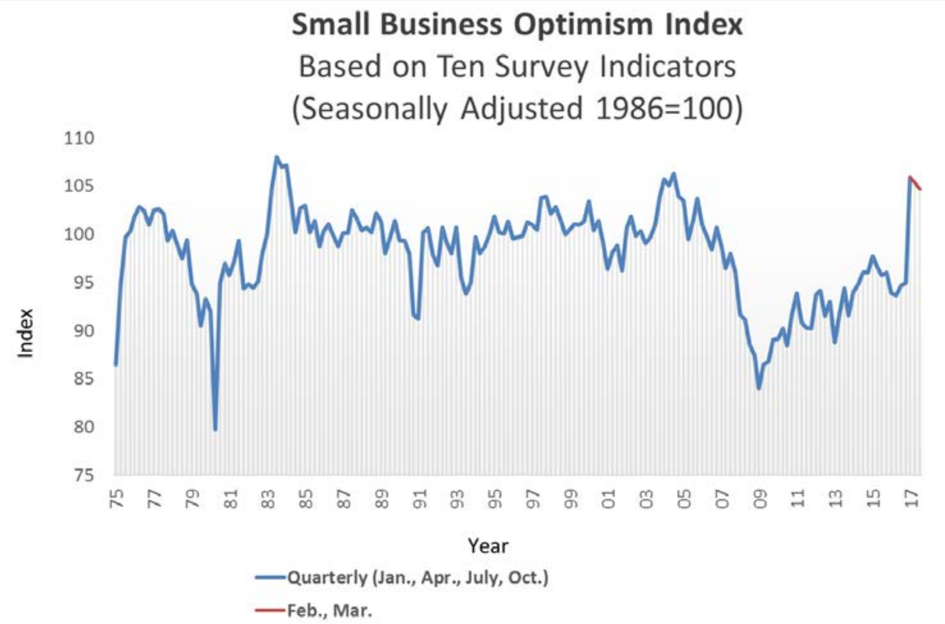
The health of the economy is critical to the successful achievement of our goals as set forth in the U.S. budget as it depends on tax revenues to support government programs. The private sector is the heart of the economy, providing the revenue that supports government operations, both spending and regulatory oversight. Small business provides the half the jobs and the tax base for revenue generation. However, over the last eight years, increased efforts to fund an ever-expanding government has weighed heavily on small businesses, restricting their ability to recover from the great recession and spur economic growth.

The current economic recovery, which began in the third quarter of 2009 according to the National Bureau of Economic Research, has been the weakest in modern history, although one of the longest. In addition to weak GDP numbers, slow economic growth is further confirmed by the NFIB Index of Small Business Optimism which, except for one quarter in 2015, failed to reach its 43-year average level through the fourth quarter of 2016.

In simple terms, a sector that contributes half of our private GDP and jobs turned in a sub-par performance throughout the recovery. This was a major factor contributing to slow GDP growth and a sub-par recovery in employment for much of this time frame. However, the change in the management team in Washington, D.C. as a result of the election has inspired many business owners, leaving them very optimistic about the future of the economy and their prospects for growth. Optimism is now at one of the highest levels observed in 43 years. Small businesses are hopeful that this will translate into policy changes that will help reduce the tax and regulatory burdens that

[1] Small Business Administration, Office of Advocacy, Frequently Asked Questions. https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf

stifle small business growth. Reducing these burdens will allow small business owners to focus their time and resources on growing their business rather than spending their energy navigating the complex tax and regulatory schemes that consume so much of their valuable resources.

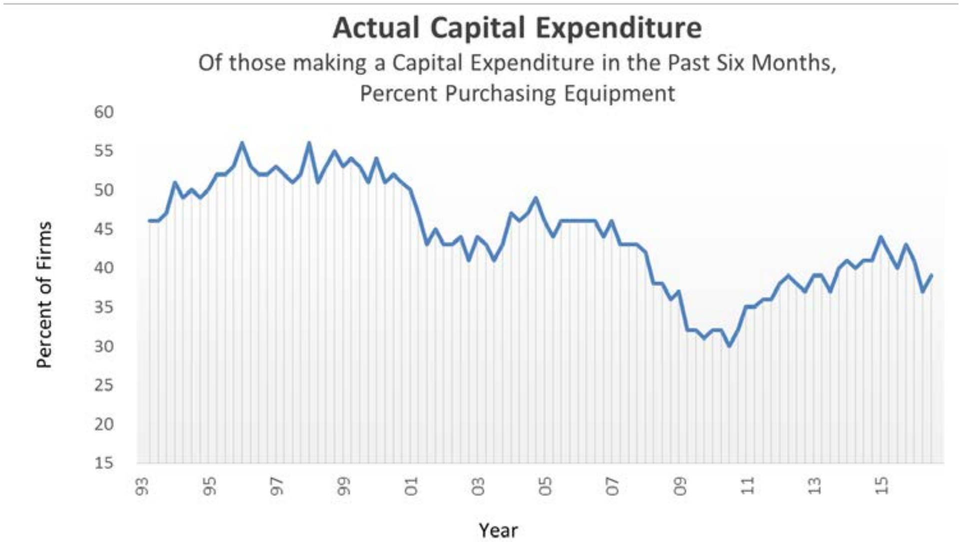


A comparison to the 1983-90 recovery which followed the last recession that produced unemployment rates over 10 percent is a perfect example of the vital importance of budget policies. In that recovery, average job creation per quarter was about 680,000 compared to 440,000 in the current recovery to date. But the workforce was 30 percent smaller in 1983 than in 2009, making the latest job creation performance even less impressive. The average growth in GDP was 4.5 percent per year (1983-1990) compared to 2.1 percent in the current recovery. And for budget purposes, the revenue implications of those differences are huge.

The government policies used to deal with each recovery were very different, one focused on empowering the private sector, the other focused on increasing the reach of government through increased regulations and taxation. The number of new regulations posted in the Federal Register over the past eight years reached record levels, this on top of a surge of state and local regulations.

Regulations are an insidious tax used by government agencies to accomplish their goals without expending government revenues or imposing explicit taxes. Instead of taxing businesses to raise funds, the government mandates through laws or regulations that owners must comply with, expending scarce resources. Each firm must cover these cost increases through lower profits initially, and then through higher prices charged to their customers. These costs, eventually passed on to consumers, are estimated to be as large in magnitude as federal income tax revenues, a second tax on private work and effort. It is not clear at all that those agencies issuing the regulations consider the cost of compliance in relation to consumer benefits. Nor does the individual regulator take into account the impact of all other regulations imposed on the small business. For example, I also serve as on the board of a small, three branch bank in NJ. And as a banker serving small businesses, I can confirm that a large share of our labor hours are spent on compliance, not growing our business or serving customers.

Growth in the economy is fundamentally driven by population growth and productivity gains. If employment grows 1 percent a year and output per hour grows 2 percent a year, GDP grows 3 percent. Longer term productivity gains depend on capital investment, new tools, faster machines, better computers, improved management techniques, new knowledge. These investments have been made at the slowest pace in 40 years in the small business sector. The surge in spending prior to "Y2K" is clear in the data, followed by a more normal level of investment which was interrupted by the Great Recession.

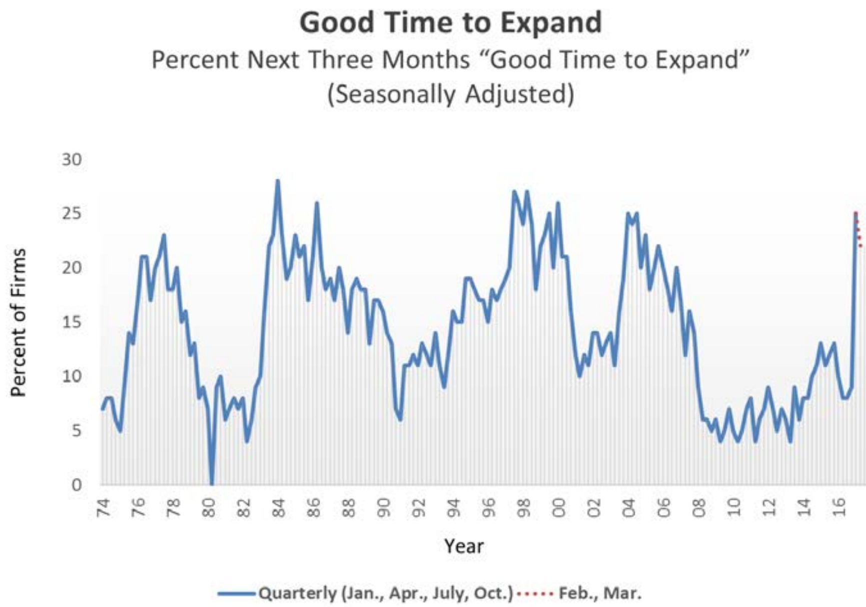


Many factors have contributed to this malaise. Regulatory compliance is costly, both in terms of actual expenditures but also in terms of labor hours used up, particularly the time of the entrepreneur, perhaps the most important asset of a firm. Compliance costs compete directly with investment spending, dollar for dollar. Private firms cannot borrow without limit and must operate within budgets. One-third of small business owners find unreasonable government regulations a critical problem in operating their businesses. Regulations are the second most severe problem for small business owners after the cost of health insurance. While owners are affected by every level of government, the federal government is the largest contributor to the problem for half of small employers.[2] Twenty-eight percent of small employers cite compliance costs as their biggest regulatory problem, followed by 18 percent were most burdened by understanding how

[2] Wade, Holly, *Regulations*, NFIB National Small Business Poll Series, February 2017, NFIB Research Foundation.

to comply with regulations. Extra paperwork is the biggest regulatory problem for 17 percent. The volume of regulations is the largest problem for 55 percent of small employers compared to 37 percent who are most troubled by a few specific regulations coming from one or two sources.

The other major damper on investment spending is the economy and the economic policies in place. High on the list of issues are profit taxes, and individual tax rates for pass-through organizations which deplete the main source of capital for most businesses to finance growth. For eight years, owners have had a dim view about the future for economy growth.



If sales are not expected to grow, then there is little incentive to expand capacity. Cheap money was available but profitable uses for the funds were not, due in large part to bad economic policies and the poor prospects for growth that resulted.

Clearly the mood of small business owners has changed. The list of their top 10 most-severe issues (out of 75 issues) makes it clear why it is important for the Administration to address all of their major issues, the cost of health insurance, the cost of regulatory compliance and the tax code, providing more certainty about policy. Over the years, we have seen owners change their tax status as Congress changed tax rates. One single rate for businesses should eliminate that waste of resources.

Small Business Problems and Priorities, 2016

Rank	Problem	% "critical" issue
1	Cost of Health Insurance	52
2	Unreasonable Government Regulations	33
3	Federal Taxes on Business Income	29
4	Uncertainty over Economic Conditions	26
5	Tax Complexity	27
6	Uncertainty over Government Actions	26
7	Frequent Changes in Federal Tax Laws and Rules	21
8	Property Taxes (real, inventory or personal property)	23
9	State Taxes on Business Income	23
10	Locating Qualified Employees	24

The quantity of their resources seized by the government through taxes and regulations, the top three items on the list, has crippled the small business sector's ability to grow as well as the incentive to invest.

Looking ahead, the prospects for economic growth depend critically on how the Administration and Congress address the issues that stand in the way of capital formation and job growth. With little prospect before the 2016 election that these issues would be addressed, owners were not optimistic about the future and were not willing to "bet" on a dismal future. The recent election changed all that and optimism is at record high levels, much like in 1983 when the record for the Index was set at the beginning of the 1983-90 expansion. If this recent spike in optimism translates into spending and hiring in the same way as in 1983, the economy is set to grow.

The question is, does the economy have the capacity to grow that fast? Eight years of sub-par growth has used up some of our excess capacity, and low levels of investment have not added to potential capacity as was the case historically. Although the unemployment rate is low, the labor force participation rate is also low, particularly for prime working age males. Unfilled job openings are at record high levels, the lack of "qualified" workers made the top 10 (out of 75 issues) list of small business owners' most severe problems for the first time since the survey started in 1982. The "double taxation" of regulatory compliance and taxes on profits are a major burden and a drag on growth, slowing capital spending and wasting entrepreneurial time.

The arrival of the new management team in Washington, D.C. revived the spirits of small business owners as the new team pledged to address the issues on their top 10 list of most severe issues and were supportive of a market economy with smaller government. The private sector has spent eight years restructuring, adjusting to the slow pace of growth and weak consumer spending. Tens of thousands of firms were lost. Owners have the capacity to grow their businesses; they just need a reason to do so and the removal of barriers that inhibit their growth is a big first step. Tax reform and regulatory relief are solid potential stimulants and implementing these in some form should be the primary goal of Congress. Adding one percentage point to the growth rate which will increase wages and entice those on the sidelines to re-enter the workforce would provide a huge boost to tax revenues to support the budget.

Only the private sector can produce real growth in the economy. Government grows only by taking resources from the private sector to support its programs. Taxes, regulations and government borrowing deplete capital available to support private sector growth, reducing both financial capital and the human capital of the private sector (the entrepreneur's time is a very valuable asset). The past eight years have made it clear that the government cannot grow the economy or create jobs. Government must have a supportive role, not leading one. Increasing the volume of regulations is not "progress", but many regulators seem to view it as such, micromanaging economic activity with little attention to the balance between costs and benefits (and "costs" are not just the budget cost, but what is lost by depriving the private sector of resources to support growth). "Less" can be "more" if reducing the size and reach of government restores to the private sector the resources and incentives to invest and grow.

I appreciate the opportunity to discuss the current state of the small-business economy and the challenges it faces going forward. And I look forward to working with the Committee to support small businesses.