

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: July 8, 2013
Re: Hearing: "Beyond the Beltway: Successful State Strategies for Small Business Growth"

Introduction

At 1:00 pm on July 10, 2013, in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet for the purpose of receiving testimony from state officials on innovative ways to entice and keep business in their states through, among other things, smart regulation, lower tax regimes, low cost of business formation, and access to capital. The hearing will examine why certain states are successful at attracting and retaining businesses in their state. The ultimate end is to determine whether these strategies can be utilized by the federal government to create a better environment for business nationwide.

A Look at the Economic Landscape Nationwide

In 2012, economic activity, as measured by gross domestic product (GDP),¹ grew by 2.5 percent, up from 1.8 percent in 2011.² The modest increase for the year was highlighted by a disappointing fourth quarter of 2012 when GDP increased by only 0.4 percent.³ Additionally, in the first quarter of 2013, GDP grew at a rate of only 1.8 percent.⁴ While GDP for last year has shown slight improvement, the United States has still suffered from the weakest economic recovery since World War II.⁵

The anemic economic growth is reflected in the labor market. In May 2013, the economy gained only 175,000⁶ new jobs and the unemployment rate increased to 7.6 percent from 7.5 percent in

¹ GDP is the market value goods and services produced by labor and property located in the United States. See OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS GDP: UPDATE 2002-2010 at 1 (Jan. 2012), available at http://www.sba.gov/sites/default/files/rs390_1.pdf.

² <http://www.bea.gov/newsreleases/national/gdp/gdphighlights.pdf>.

³ *Id.*

⁴ <http://bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>.

⁵ Michael Sivy, *What the Current Economic Outlook Means for American Families*, TIME (Jan. 16, 2013), available at <http://business.time.com/2013/01/16/what-the-current-economic-outlook-means-for-american-families/>.

⁶ <http://www.bls.gov/news.release/empsit.nr0.htm>.

April 2013.⁷ Despite the new jobs being created, there continue to be 11.8 million workers who have dropped out of the labor force and are no longer actively looking for work.⁸ According to JPMorgan Chase, the sluggish pace of job growth will continue in 2013 with the economy adding approximately 175,000 jobs per month.⁹ This projection is far short of the 300,000 jobs per month that many economists believe is necessary for a more robust recovery.¹⁰

In contrast to the lagging labor market, housing prices are currently growing at their fastest level since 2006,¹¹ signaling an end to the steep declines that were a leading cause of the 2008 financial crisis.¹² Despite the rebound, housing's contribution to the economy is not as significant as it was prior to the financial crisis; housing now represents only 2.2 percent of GDP down from 6 percent.¹³

The struggles in the labor market and housing affect consumer spending.¹⁴ Consumer spending, which accounts for 70 percent of overall economic activity, declined 0.2 percent in May 2013.¹⁵ Given the importance of consumer spending in the United States economy, reductions in consumption are likely to act as a brake on economic growth.

Different States, Different Outcomes

Although the overall national numbers have shown exceptionally weak growth following the recession, some states have bucked the trend and outpaced the national averages, some by significant margins. For example, North Dakota led the nation with a 13.4 percent increase in GDP¹⁶ in 2012.¹⁷ Similarly, states such as Texas, Utah, and Indiana outpaced the 2.5 percent

⁷ <http://data.bls.gov/timeseries/LNS14000000>.

⁸ BUREAU OF LABOR STATISTICS, THE EMPLOYMENT SITUATION – MAY 2013 at 1, available at <http://www.bls.gov/news.release/pdf/empisit.pdf>. [hereinafter BLS Employment Situation].

⁹ JPMORGAN, THE US ECONOMIC OUTLOOK FOR 2013 at 2, available at https://markets.jpmorgan.com/research/EmailPubServlet?action_open&hashcode=990nmr0i&doc=GPS-1020810-0.pdf.

¹⁰ Catherine Rampell, *Job Creation is Still Steady Despite Worry*, N.Y. TIMES, Jan. 4, 2013, available at <http://www.nytimes.com/2013/01/05/business/economy/us-economy-adds-155000-jobs-jobless-rate-is-7-8.html>.

¹¹ JPMORGAN, THE US ECONOMIC OUTLOOK FOR 2013 at 4, available at https://markets.jpmorgan.com/research/EmailPubServlet?action_open&hashcode=990nmr0i&doc=GPS-1020810-0.pdf.

¹² FINANCIAL CRISIS INQUIRY COMMISSION, FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 213 (2011), available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

¹³ Agustino Fontevicchia, *Housing Recovery Firm, But Don't Expect a Return to Pre-Crisis Growth*, FORBES, Jan. 29, 2013, available at <http://www.forbes.com/sites/afontevicchia/2013/01/29/housing-recovery-firming-but-dont-expect-it-to-spark-pre-crisis-growth-this-time/>.

¹⁴ See C. JONES, MACROECONOMICS: ECONOMIC CRISIS UPDATE 249-51, 346 (2010) (discussing consumer spending patterns and their effect on growth rates).

¹⁵ Shobhana Chandra, *Consumer Spending in U.S. Rose in December as Incomes Surged*, BLOOMBERG, Jan. 31, 2013, available at <http://www.bloomberg.com/news/2013-01-31/consumer-spending-in-u-s-climbed-in-december-as-incomes-surged.html>.

¹⁶ In this instance, and other instances when referring to a particular state throughout this memorandum, these are references to the individual state's Gross Domestic Product.

¹⁷ BUREAU OF ECONOMIC ANALYSIS, ADVANCE 2012 AND REVISED 2009—2011 GDP—BY—STATE STATISTICS, June 2013, available at https://www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm. [hereinafter JUNE BEA RELEASE]

national average.¹⁸ Not surprisingly, unemployment in these states tended to be lower than the national average. In May 2013, North Dakota again led the country with a 3.3 percent unemployment rate, with Virginia, Texas and Kansas all coming well under the national average of 7.6 percent.¹⁹

Conversely, and a mathematical truism, if some states outpace the national average, some states will fall below. Nevada has the highest unemployment in the nation at 9.6 percent²⁰ and a GDP growth of only 1.5 percent.²¹ Other states, such as Rhode Island and Michigan, have similar unemployment numbers that are higher than the national average and GDP growth lower than the national average. While the root causes of such disparities are outside the scope of this memorandum and hearing, several surveys and studies have attempted to quantify what makes some states more successful than others at attracting new business and keeping those businesses growing. It is to this topic which we now turn.

Surveys and Studies

Each year, several news organizations, trade associations, and think tanks release studies and surveys that rank the 50 states in terms of business friendliness. Among those are CNBC's "Americas Top States For Business,"²² Forbes.com's "The Best States for Business,"²³ and the Ewing Marion Kauffman Foundation and Thumbtack.com's "Small Business Friendliness Survey."²⁴ Each of the studies examined, among other things, the cost of doing business,²⁵ regulatory environment, economic climate,²⁶ and workforce.²⁷ Links to all of the surveys and their methodologies are located in the footnotes of this memorandum.

While the methodologies for each of these surveys were not identical, several states, such as Virginia, Utah, Texas, and the Dakotas consistently score high. While vast and previously inaccessible energy resources (such as oil and natural gas) have significantly helped the Dakotas and several mid-western states in the rankings, it cannot be overstated that several of these states have made a commitment to fostering a business-friendly environment that has helped them outpace the overall GDP growth and kept unemployment lower than national averages.

¹⁸ *Id.*

¹⁹ <http://www.bls.gov/web/laus/laumstrk.htm>.

²⁰ *Id.*

²¹ JUNE BEA RELEASE

²² <http://www.cnbc.com/id/100016697>

²³ <http://www.forbes.com/sites/kurtbadenhausen/2011/11/22/the-best-states-for-business/>.

²⁴ <http://www.kauffman.org/newsroom/small-businesses-rate-utah-and-alabama-friendliest-states-california-and-illinois-among-least-friendly.aspx>.

²⁵ Business costs are most often defined as the state and local tax burden, utility and energy costs, rent or mortgage prices, and labor costs.

²⁶ Economic climate is measured by job, income, and gross domestic product growth, as well as unemployment.

²⁷ Workforce is measured by the number of high school, trade or technical school and college graduates based on information from the United States Census Bureau. Additional factors in this category include net migrations over the past few years and the percentage of the workforce that is represented by a union.

Common Themes

Throughout each of the studies, commonalities between the top-ranking and bottom-ranking states appear. For instance, three of the states represented by witnesses in this hearing, Virginia, Kansas, and South Dakota, all finished in the top third of CNBC's business friendliness category. Additionally, these states were all in the top 12 in that category in the Forbes study. While the Kauffman study did not rank states in with numeric values like CNBC and Forbes, Virginia and Kansas earned "A" grades for their tax regimes. In the Forbes survey, Virginia and South Dakota each ranked in the top 10 for their economic climate.

Although it cannot be determined that low taxes cause low unemployment, it is hard to ignore the correlation that Virginia at 5.3 percent, South Dakota at 4 percent, and Kansas at 5.7 percent²⁸ all have significantly lower unemployment than the national average of 7.6 percent. Conversely, states that did poorly in the rankings, such as Rhode Island (8.9 percent), Mississippi (9.1 percent) and Michigan (8.4 percent),²⁹ have significantly higher unemployment numbers than the national average.

What States Are Doing

States have the capability to affect their local economies irrespective of federal actions. For example, in 2011, Utah Governor Gary Herbert initiated a review of the state's nearly 2,000 administrative rules. Following this retroactive review, the state eliminated or modified 368 regulations that were shown to be detrimental to business growth, outdated, or outmoded.³⁰ In Kansas, Governor Sam Brownback established the Office of the Repealer in 2011 which recommended 51 various state executive orders, regulations, and laws that outdated and unnecessary.³¹ Additionally, in 2012, Governor Bob McDonnell launched a regulatory reform effort very similar to Kansas' Office of the Repealer in an effort to repeal unnecessary and burdensome regulations.³²

Tax policy also offers popular mechanisms to help attract and grow businesses. Governor Brownback has worked with the Kansas legislature to lower the state income tax several times since taking office. In 2011 when he took office, the state's income tax rate was 6.45 percent and 3.0 percent for higher and lower income individuals respectively. Under legislation signed earlier this year, those rates will fall to 3.9 percent and 2.3 percent by 2018.³³ In addition, the Governor signed a bill in 2012 to exempt pass-through entities (LLCs, S corps, partnerships,

²⁸ <http://www.bls.gov/web/laus/laumstrk.htm>.

²⁹ *Id.*

³⁰ THE TAX FOUNDATION, UTAH BUSINESS REGULATION REPORT 3 (Dec. 2011), *available at* http://www.scribd.com/fullscreen/83192302?access_key=key-kh6b25p9gt5spcfqz3i&allow_share=true.

³¹ KANSAS, OFFICE OF THE GOVERNOR, ADMINISTRATION RECOMMENDS 51 STATE LAWS, REGULATIONS AND EXECUTIVE ORDERS FOR REPEAL, Jan. 2012, *available at*:

<http://repealer.ks.gov/documents/RepealerNewsRelease.pdf>.

³² <http://www.regreform.virginia.gov/>.

³³ 2013 Kans. Sess. Laws 135, *available at*

http://www.kslegislature.org/li/b2013_14/measures/documents/summary_hb_2059_2013.pdf.

farms, and sole proprietorships)³⁴ from income tax, thus eliminating income tax on an estimated 191,000 Kansas small businesses.³⁵ Additionally, South Dakota is one of only seven states with no personal income tax.

Conclusion

The United States is experiencing the weakest economic recovery since World War II, and many economists predict that the slow growth will continue throughout 2013. While the country is slowly moving toward economic recovery, several states have established significantly better business environments than others. The outcomes of the several surveys and studies mentioned in this memorandum, coupled with unemployment and GDP numbers, show that some states are doing much better at attracting and retaining businesses, creating jobs, and growing their economies than other states. This hearing represents an opportunity for Members to learn successful strategies from state officials that can correlate to the national agenda for creating jobs and growing the economy.

³⁴ Pass-through entities are the most common form of small business structure and account for approximately 54 percent of all net income and employ 54 percent of the private sector workforce. In a pass through structure, the income of the small business is “passed through” to the business owner, who pays the firm’s taxes of their individual tax return.

³⁵ Mark Davis & Deon Lefler, *Brownback Betting Tax Cuts Lure Business to Kansas*, WICHITA EAGLE, January 12, 2013, available at <http://www.kansas.com/2013/01/12/2633770/brownback-betting-tax-cuts-lure.html>.