

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: March 20, 2017
Re: Hearing: "Making Washington Work for America's Small Businesses"

I. Introduction

On Wednesday, March 22, 2016 at 11:00 a.m., the Committee on Small Business will conduct a hearing titled, "Making Washington Work For America's Small Businesses." The purpose of the hearing is for small business owners to outline their priorities and provide the Committee with ideas about federal policies that will help them most grow their businesses. A priority setting hearing, the hearing will help inform future committee hearings, advocacy efforts, and legislative priorities for the Committee on Small Business for the 115th Congress.

II. Small Business and the American Economy

Small businesses¹ play a critical role in the United States economy. They comprise 99.9 percent of all firms, 48 percent of private sector employees (57 million out of 118 million) and 41.2 percent of private sector payroll.² Small firms accounted for 63.3 percent of the net new jobs created between 1993 and mid-2013 (or 14.3 million of the 22.9 million net new jobs). Small businesses also account for about 46 percent of the nonfarm, private real gross domestic product.³

Not surprisingly, small businesses lead the way in a plethora of segments of the American economy. For example, small firms make up the majority of United States' exporters. The most recent data from the Bureau of the Census identified 285,889 small business exporters in 2015, which accounts for nearly 98 percent of all exporters.⁴ Of the number of identified small business exporters, 39 percent have less than 20 employees and 55

¹ There are multiple definitions of small business and this memorandum adopts one such categorization, less than 500 employees.

² UNITED STATES SMALL BUSINESS ADMINISTRATION, OFFICE OF ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2016) [hereinafter "Advocacy FAQs"], available at https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf.

³ KATHRYN KOBE, SMALL BUSINESS GDP: UPDATE 2001-2012, OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION 1(2012), available at https://www.sba.gov/sites/default/files/rs390tot_1.pdf.

⁴ <https://www.census.gov/foreign-trade/Press-Release/edb/2015/2015prelimprofile.pdf>.

percent have less than 100 employees.⁵ Of the small firms with less than 20 employees, 55 percent export to one market, and only 29 percent export to between one and four countries.⁶

New and small businesses are also much more efficient at creating innovation than old and large businesses, and innovation is a key driver of economic growth.⁷ According to a report issued by the Small Business Administration Office of Advocacy in 2002, small businesses invented and managed an average of 10.01 products, and large businesses invented and managed an average of 21.44 products.⁸ Although larger businesses invented roughly twice as many products, the products-to-employee ratio was significantly higher for small businesses than their larger counterparts. In terms of the number of patents obtained per dollar spent on research and development (R&D), small-young businesses obtained 2.41 times more patents than large-young businesses for every dollar spent on R&D, and small-young businesses obtained 2.5 more patents than small-old businesses.⁹ This means that larger and older businesses have to invest more in research and development to produce the same amount of innovation as smaller and younger businesses.

Additionally, in fiscal year 2015, 25.8 percent of federal contracting dollars went to small businesses, up from 25.1 percent in FY 2014 and 23.4 percent in FY 2013.¹⁰ Of agencies with at least \$1 billion in eligible contract dollars, the ones that awarded the highest share of contracting dollars to small firms were the Departments of the Interior with 55.4 percent, Transportation at 50.6 percent, and Agriculture at 50.1 percent.¹¹

Small businesses are also at the forefront of the recent lowering of unemployment rates. A little more than half of the net number of jobs created since employment began growing in 2010 have been generated by firms with fewer than 250 employees, and most of that amount was accounted for by firms with fewer than 50 employees.¹² Small firms are leading a recent job creation resurgence in the first two months of this year. January saw the economy add 246,000 new jobs, of which 96,234 were created by small firms¹³. February 2017 showed the strongest job growth in at least 19 months, with 226,000 new small firm jobs out of the total of 298,000.¹⁴

⁵ ITC, SMALL AND MEDIUM-SIZED ENTERPRISES: CHARACTERISTICS AND PERFORMANCE xiv (2010) 11 available at <http://www.usitc.gov/publications/332/pub4189.pdf>. 11.

⁶ *Id.* at 35.

⁷ Harvard Professor Philippe Aghion's model suggests that without innovation, the economy cannot grow. Innovation increases the productivity of capital, and without that innovation, there is a point in the production function where the economy cannot increase marginal output without more innovation. Philippe Aghion, *Entrepreneurship and growth: lessons from an intellectual journey*, 48 SMALL BUS. ECON. 9 (2017) 48.

⁸ JOSE PLEHN-DUJOWICH, PRODUCT INNOVATIONS BY YOUNG AND SMALL FIRMS, SBA OFFICE OF ADVOCACY, (2013), available at <https://www.sba.gov/sites/default/files/files/rs408tot.pdf>.

⁹ *Id.*

¹⁰ Advocacy FAQs, *supra* note 2, at 3.

¹¹ *Id.*

¹² <http://www.federalreserve.gov/newsevents/speech/yellen20140515a.htm>.

¹³ <http://www.adpemploymentreport.com/2017/January/SBS/SBS-NER-January-2017.aspx> (Historical Data).

¹⁴ <http://www.adpemploymentreport.com/2017/February/NER/docs/ADP-NATIONAL-EMPLOYMENT-REPORT-February2017-Final-Press-Release.pdf>.

III. Challenges Facing Small Firms

In 2016, the National Federation of Independent Business (NFIB) released the results of its “Small Business Problems and Priorities” assessment.¹⁵ This survey reveals that small business owners experience a wide variation of business-related problems presenting varying degrees of difficulty. Some problems are merely irritations while others are precarious in nature. Some are experienced by most small-business owners while others affect selected populations.¹⁶ The prevalence and severity of issues often depend on the specific characteristics of the business. The impact of certain matters might be determined by whether the business sells good or services, by its number of employees, or a myriad of other factors.¹⁷ But the common thread with many of these issues is that they divert owners’ capital, time and attention away from operating their business.¹⁸ The NFIB survey found that the 5 most severe problems for small-business owners are the cost of health insurance, unreasonable government regulations, federal taxes on business income, uncertainty over economic conditions and tax complexity.¹⁹

The cost of health insurance was again the number one concern listed in the NFIB survey. In fact, 52 percent of small-business owners in the NFIB analysis cited the cost of health insurance as “critical.”²⁰ Additionally, the National Small Business Association (NSBA) released a survey late in 2015 that found that, while the majority of employers think offering health insurance is very important to recruiting and retaining good employees, just 41 percent of firms with zero to five employees offer health benefits, down from 46 percent in 2014.²¹ Overall, 65 percent of small firms (those with fewer than 500 employees) report offering health insurance today, down from 70 percent in 2014.²² For the smallest firms, those with zero to five employees, the offer rate is less than half that of their counterparts with 20 or more employees.²³

Other surveys and studies by other entities add weight to the top five problems found in the NFIB study as well. For instance, a 2014 study and survey by the National Association of Manufacturers found that United States federal government regulations cost America an estimated \$2.028 trillion in 2012 (in 2014 dollars), an amount equal to 12 percent of GDP.²⁴ The cost of those regulations are not spread equally among all segments of the economy. Considering all federal regulations, all sectors of the United States economy and all firm

¹⁵ HOLLY WADE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, SMALL BUSINESS PROBLEMS AND PRIORITIES 7 (2016), available at <http://www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf>.

¹⁶ *Id.* at 7.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 5.

²⁰ *Id.*

²¹ NATIONAL SMALL BUSINESS ASSOCIATION, SMALL BUSINESS HEALTH CARE SURVEY 2 (2015), available at <http://www.nsba.biz/wp-content/uploads/2015/11/Health-Care-Survey-2015.pdf>.

²² *Id.*

²³ *Id.*

²⁴ W. MARK CRAIN AND NICOLE V. CRAIN, NATIONAL ASSOCIATION OF MANUFACTURERS, THE COST OF FEDERAL REGULATION TO THE U.S. ECONOMY, MANUFACTURING AND SMALL BUSINESS 1 (2014) available at <http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Full-Study.pdf>.

sizes, federal regulations cost just less than \$10,000 per employee per year.²⁵ Small firms with fewer than 50 employees incur regulatory costs (\$11,724 per employee per year) that are 17 percent greater than the average firm.²⁶ The cost per employee is \$10,664 for medium-sized firms and \$9,083 for large firms.²⁷ Therefore, small businesses pay, on average, \$2,641 more per employee per year to comply with federal regulations.

While many federal regulations may be required by statute and well-intended, agencies simply are not adequately assessing the effects on small firms nor considering significant alternatives that would still permit them to achieve their public policy objectives. As a result, small businesses continue to encounter serious challenges complying with rules and rules may be subject to litigation.

The federal tax burden, along with its complexity, is another concern for small firms, as outlined by the NFIB survey. The United States tax code is incredibly complex, and nowhere is this felt more keenly than among the small business community. Small businesses face unique challenges when dealing with the code. Entrepreneurs must struggle to decipher the code, file paperwork and pay their taxes, all while keeping their businesses running. As new taxes are implemented, and tax rates increase, small business owners must familiarize themselves with these laws, or hire a professional to do so, and ensure that their company complies.

While their larger counterparts most certainly deal with a great deal of complexity in the Code, economies of scale result in an astronomically higher per-employee cost of compliance for small businesses. Corporations and partnerships with more than 50 employees face a tax compliance burden of approximately \$182 to \$191 per employee, but this number skyrockets to \$4,308 to \$4,736 per employee for the smallest employers with 1-5 employees.²⁸

The NSBA recently released its Small Business Regulations Survey.²⁹ More than half of the survey participants had less than \$1 million in gross sales or revenues for the most recent tax year.³⁰ Seventy-five percent of participants said that federal tax code regulations are very or somewhat burdensome, and tax-related regulations led the rankings as the most burdensome of all types of regulatory compliance.³¹

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Small Businesses, IRS Considers Compliance Burden in Tax Administration, but Needs a Plan to Evaluate Its Payment Card Information Pilot: Hearing Before the United States House of Representatives Committee on Small Business*, 114th Congress, First Session (July 22, 2015) (testimony of J. Christopher Mihm), available at <http://www.gao.gov/products/GAO-15-754T>.

²⁹ NATIONAL SMALL BUSINESS ASSOCIATION, SMALL BUSINESS REGULATIONS SURVEY (2017), available at <http://www.nsba.biz/wp-content/uploads/2017/01/Regulatory-Survey-2017.pdf>.

³⁰ *Id.* at 3.

³¹ *Id.*

The final top concern listed in the NFIB survey, uncertainty over economic conditions, is, generally, a concern for all businesses and not just small firms. While there is light at the end of the tunnel following the Great Recession, economic activity, as measured by GDP, grew by just 1.6 percent in 2016.³² This number falls below the GDP growth rates of 2015 and 2014, when the growth rates were 2.6 percent and 2.4 percent, respectively.³³ Over the past eight years, GDP growth averaged just 1.5 percent.³⁴ By comparison, the United States averaged 3.5 percent GDP growth from 1950 until 2000.³⁵ Even though there are signs that the economy is improving, the current GDP growth rate is well below historical average. Absent changes in policy direction, the Congressional Budget Office estimated in January 2017 that GDP growth is projected to be 1.7 percent from 2017-2020 and 1.9 percent from 2021-2027.³⁶

Conclusion

In recent years, small businesses have consistently identified a preponderance of regulatory burdens, excessive taxation, and a state of general confusion understanding the myriad of policies and mandates coming from the federal (and often compounded by their states') government. This hearing represents an opportunity to hear from small businesses about the obstacles that hinder the success of both current and future small business owners.

³² <https://www.bea.gov/national/index.htm#gdp>.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ CONGRESSIONAL BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK 2017 TO 2027 117 (2017), available at https://www.cbo.gov/sites/default/files/52370-Outlook_OneColumn_0.pdf.