

Testimony of  
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On

**Is Uncertainty Contributing to the Jobs Crisis:  
The Views of Local Illinois Small Businesses**

Before

the House Committee on Small Business  
Subcommittee on Economic Growth, Tax and Capital Access

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Chairman Walsh, Ranking Member Schrader, and esteemed members of the Sub-Committee on Economic Growth, Tax and Capital Access, thank you for inviting me here today to speak with you about the difficulties that small businesses face in today's uncertain political and economic environment.

My name is Craig Larsen. I am a CERTIFIED FINANCIAL PLANNER™ and President of AHC Advisors, Inc., a St. Charles, Illinois company that provides financial planning, investment management, and consulting services to individuals, businesses, governmental bodies, and pension funds. AHC is a fee-only investment company which means that we are paid directly by our clients, and not from commissions on the investments that our customers make. This enables us to give investment advice that is not based upon which investment will pay the highest commission, but rather on which investment is in the client's best interest. AHC is an independent firm that is not affiliated with any bank or brokerage company. We are a fiduciary to our clients at all phases of the investment relationship. As a fiduciary we put our client's interests ahead of all other interests, including our own, at all times. In addition, I presently serve as Treasurer of the Financial Planning Association of Illinois.

I formed my company in 1995, after beginning my career at the Chicago Mercantile Exchange and Chicago Board of Trade in 1987. My company is a small business. I have one full time employee, and one part time employee. My company is expanding and I need to hire another person. I will relate some of the challenges that I am facing later in my testimony.

My testimony today is shaped by my experience as a small business owner, a financial planner and wealth manager who deals with business owners, a former elected Township Trustee, and an observer of the political process.

My comments will focus on the uncertainty that businesses face regarding tax policy, as well as regulation.

Before I go into detail I want to state that from my perspective there are signs of optimism in our economy. Although unemployment is still too high and house prices are still significantly lower than their peak, retail sales are growing, business activity is improving, and the consumer has pared their debt burdens back to levels that make it much more likely that they will be able to expand spending in the future.

I see the glass as half full for the US economy, but a great deal of economic uncertainty remains. Some of this uncertainty is not in our direct control. For example we could be impacted by the credit crisis in Europe, or by an economic slowdown in the emerging markets. However there are some factors that policymakers can impact; namely the uncertainty created by unsettled tax and regulatory policy. This uncertainty has an impact on business planning and job creation.

## **TAX POLICY**

The first area I would like to focus on is tax policy. The tax code is continuously being modified. The changes are often made to spur certain behaviors, reward favored industries, punish disfavored industries, and reward specific constituencies. These changes have been supported by both Democrats and Republicans over time.

The tax code is often used as a political tool to promote or discourage activity in the various sectors of the economy. In essence the government selects the winners through various subsidies and tax breaks. The government also dictates the losers through less favorable tax treatment and the absence or removal of subsidies.

At present there is great uncertainty regarding what future tax rates will be, as well as who will be favored and disfavored by any changes in the tax code. Congress does not look like it will extend many tax provisions that expire this

year, such as the alternative minimum tax (AMT). I believe this is adding tremendous and unnecessary uncertainty to businesses, both large and small, as it relates to planning for the future.

The current tax rates will be in effect until the end of 2012. The inability to reasonably predict future rates on income, capital gains and dividends has a dampening effect on businesses. New business projects, or an expansion of existing ventures, are evaluated by using models that estimate take-home profits over the life of the project. A very important component of this evaluation is the expected tax rate.

It is my opinion that uncertainty about future tax rates is hindering job growth in our country. If businesses are unable to reasonably predict future tax rates how can they be expected to expand or undertake new projects on the margin if it is possible that future tax rates could be so high as to make these projects unprofitable? If businesses don't expand existing projects, or take on new projects, employment growth will remain muted.

Tax-favored industries and business are subject to change over time as our political leadership changes. I believe this adds a dimension of political uncertainty to business planning because today's winners may be tomorrow's losers if the political leadership changes. Therefore any rational business needs to consider this eventuality and plan accordingly. This may lead to an intense focus on short-term profits to be earned before the political winds shift against the business. This focus on the short-term may be detrimental to long-term growth for the business. This is not the way to encourage long-term healthy economic growth in our country.

Milton Friedman won the Nobel Prize in Economics in 1976. Friedman's work included the permanent income model, which included the observation that temporary tax cuts have less effect on consumption than economists had previously thought. Because temporary tax cuts are likely to be reversed, people

react rationally by making consumption decisions based upon their longer-term income expectations.

Instead of working to set long-term tax rates, our recent political process has concentrated on short-term, one-time tax rebates and temporary tax rate changes. These temporary tax measures have been the product of both Republican and Democratic administrations. It is my opinion that, as Milton Friedman found, these temporary measures do little to stimulate long-run economic growth, and just add to our mounting national debt.

Tax policy is not only a federal issue. Here in Illinois, the state income tax rate has increased. The added tax burden reduces the ability of businesses to hire new employees as revenue is diverted from businesses profits to the state. Several large firms based in Illinois have threatened to leave the state as a result of these tax increases. At present the Chicago Mercantile Exchange (CME) and Sears are considering moving out of state if they don't get tax relief.

Finally, our tax code is tremendously complex, and continues to grow in complexity. In 1986, the goal of tax reform was to make the code more fair and simple. Since that time, there have been tens of thousands of changes and additions, each with its own set of rules, requirements, and phase-outs. This complexity, and the likelihood that it will continue to increase, adds to business uncertainty. Many of these changes are driven by special interests who are able to secure preferential treatment. In Illinois both the CME and Sears are seeking preferential treatment that won't be available to small businesses.

Although differences in political philosophy will shape an individual's view of how the tax code should be written, it cannot be disputed that more complexity and uncertainty in the tax code reduces the likelihood that business will invest in existing or new projects that will produce economic growth and, most importantly, create jobs.

## **REGULATION**

In addition to writing legislation, federal, state and local governments are heavily involved with picking winners and losers through the regulatory process. These regulations tend to change over time, but are especially driven by changes in which political party in charge. Government regulatory activity increases the uncertainty in the business planning process, as industries must calculate that probability they may fall into disfavor in the future. I would like to stress that Republicans as well as Democrats have used regulatory policy as a means to pick winners and losers.

Increasing regulatory burdens are also having a dampening effect on economic growth and job creation. Although there has been a significant increase in regulation of many industries including health care and energy, I am going to focus on the industry in which my company is engaged – Financial Services.

The financial services industry is one of the most heavily regulated sectors of our economy. There are tens of thousands of pages that regulate financial companies. Often new regulations are passed in reaction to current events. For example Sarbanes Oxley and the Dodd Frank bill were both passed on the heels of traumatic market problems. However, what we see time and again is that new regulations don't eliminate problems in the future, even in the areas that they were specifically designed to address.

The Madoff scandal is a good example. What he did violated laws that were currently on the books, and I don't believe that additional regulations would have stopped him from engaging in fraudulent behavior.

Often after regulations are written they are subject to interpretation by regulatory bodies and the courts. In some cases there may be regulations that only become clear after regulators or the courts have had their say. Much of the regulatory code that governs the financial services industry was written in the 1930's and 1940's, and can be ambiguous in today's market environment.

Compliance is so complex that I have outsourced this area to an outside legal firm. Despite this, we spend quite a bit of time internally dealing with compliance issues. I estimate that our external and internal regulatory compliance costs exceeds \$10,000 per year. These costs have increased since the passage of Dodd Frank. This is time and money that could otherwise be spent growing my business. Many firms in my industry have been sold by their owners, or merged with other firms, in the face of the burdens of ever growing regulations and escalating costs of compliance.

It is important to remember that every dollar spent on compliance is a dollar less that firms have available to pay new employees. In my industry that means that employment growth is shifted from a productive firm to one in another industry that is growing by virtue of gaining more business from firms who are struggling to deal with ever growing regulatory burdens. Not surprisingly, the very same firms that offer services to deal with increasing regulatory burdens often support these increased regulations. It is a profit engine for them.

I think a strong argument can be made that transferring resources from profit making activities to dealing with increased regulatory burdens won't have a positive effect on long-term economic growth, and job creation.

However, I don't believe that all regulations are bad. A set of consistent, clear, and reasonable regulations are important to have. Unfortunately that is not what we have in the financial services industry. Instead we have financial regulations that are vague and ambiguous in many areas, and in large part the product of the lobbying efforts of the very same financial institutions that were at the heart of the financial crisis.

A necessary update to current financial regulation would be the implementation of a common fiduciary standard among all "financial advisors" who give personalized investment advice. Currently some advisors act in the best interest



of their clients as a fiduciary at all times. My company operates in this manner. Other advisors are not required to do so. This creates uncertainty in the industry and confusion for consumers. The Financial Planning Association (FPA), the CFP Board of Standards, and the National Association of Personal Financial Advisors (NAPFA) have joined together to advocate for a strong fiduciary standard for all financial advisors who give personalized investment advice.

### **MY EXPERIENCE AS A BUSINESS OWNER**

My business is expanding. Last year, I hired a full-time employee and my company became eligible for a \$2,500 tax credit through the Illinois *Small Business Jobs Creation Tax Credit*. Although I appreciate the tax credit, it only helps offset costs for one year. The costs of hiring and retaining an employee long term are much greater than this one-time tax credit. So much so that in my case I would have made the hiring decision even if the tax credit wasn't available. This goes back to the work of Milton Friedman that I referenced earlier – economic decisions are made based upon long-term expectations, and not short-term tax incentives.

I need to hire more people. However the costs of recent tax increases and compliance costs, along with uncertainty regarding future taxes and regulatory burdens, make it difficult to do so. I would like to hire a full-time employee. However, given elevated costs elsewhere, and potentially even greater costs in the future, I have made the decision to only hire a part time employee.

The financial burden that my business faces from the increase in the state income tax, increased regulatory costs, and rising insurance costs, combine to represent a large part of an employees salary. I can quantify these costs.

However, I cannot quantify what future tax rates will be, or, with respect to regulation, if I will find my company in a favored or disfavored group. I do know that given the huge size of the national debt, I am expecting my tax rates to be

higher in the future. But, I do not have a clue as to how much higher they might be.

When I hire an employee, like most businesses, I want the employee to be with my firm for a long time. However, the uncertainty in tax and regulation policy make it difficult to make informed hiring decisions because I have uncertainty about what my costs will be. There are other areas that I have to consider in making employment decisions, for example employment law and health care regulations, but in the interest of time I will not touch on them today.

How am I supposed to make informed and rational decisions on hiring when there is so much uncertainty? As I mentioned earlier, in the face of increased tax rates and escalating costs of dealing with regulations I have determined that the prudent path for my company is to hire a part-time instead of a full time employee. I don't believe that I am alone. I think that businesses, large and small, are dealing with similar issues, and that this directly contributes to the stubbornly high unemployment rate that we face today in the United States.

It is my hope that we can leave the environment of tax uncertainty and excessive, politically driven regulations behind us. Our country would be better off if we put in place a set of limited, but common sense regulations, and a tax code that is less complex and provides businesses the certainty of knowing what their tax rates will be in the future. Businesses would then be able to plan for the future, grow, hire even more employees, and get our country back on a path of growth and prosperity.