



Adrift Without a Compass:

How Uncertainty Created by the Obama Administration’s Agenda Is Harming Small Businesses, the Economy, and Jobs

**A Report by House Small Business Committee Republican Staff
October 2012**

“We have been in business 32 years as a family-owned S Corp and have weathered ups and downs before....but the uncertainty of what our health care costs will be next year, the prospects of higher taxes and what is happening with the national debt...why should we expand?”

**Keith Kramer, Keith M. Kramer and Associates,
St. Louis, Missouri**

Submitted to the House Small Business Committee’s “Open Mic” Web Forum

Policy uncertainty isn’t just a political talking point; it’s a real phenomenon receiving increased attention in academic and economic policy circles.

While economists generally agree that the lackluster economic growth and persistently high unemployment are the results of many factors, it is also becoming clear that government policy indecision and vagueness are contributing to, and in some cases exacerbating, the ills plaguing our economy.

Policy uncertainty – and how it is affecting small business decision making and its costs – is the subject of three recent studies by researchers at the Federal Reserve Bank of Cleveland,¹ the University of Chicago School of Business,² and the Federal Reserve Bank of San Francisco.³

These reports, combined with recent small business owner opinion surveys, add to a growing body of evidence that the Obama Administration’s policy agenda, and the uncertainty it creates, are harmful to small businesses, job creation and economic growth.

¹ Mark Schweitzer and Scott Shane, ECONOMIC POLICY UNCERTAINTY AND SMALL BUSINESS EXPANSION, ECONOMIC COMMENTARY, THE FEDERAL RESERVE BANK OF CLEVELAND (November 29, 2011), available at <http://www.clevelandfed.org/research/commentary/2011/2011-24.cfm>.

² Scott Baker, Nicholas Bloom & Steven Davis, MEASURING ECONOMIC POLICY UNCERTAINTY, THE UNIVERSITY OF CHICAGO BOOTH SCHOOL OF BUSINESS (October 11, 2011) (hereinafter “University of Chicago Uncertainty Study”), available at <http://faculty.chicagobooth.edu/steven.davis/pdf/PolicyUncertainty.pdf>.

³ Sylvain Leduc and Zheng Liu, UNCERTAINTY, UNEMPLOYMENT, AND INFLATION, ECONOMIC LETTER, FEDERAL RESERVE BANK OF SAN FRANCISCO (September 17, 2012), (hereinafter “San Francisco Fed Study”) available at <http://www.frbsf.org/publications/economics/letter/2012/el2012-28.pdf>.

Small Businesses Need Certainty to Invest, Grow and Hire

“In the last four years, the federal government has enacted significant policy changes of an immense nature; their impact will continue as the regulatory system works to implement new policy directives....All of these policy changes create a huge ‘question mark’ for small business owners, impeding their ability to make short and long-term business decisions.”

Small Business Problems and Priorities
National Federation of Independent Business
August 2012⁴

The role of uncertainty in business decision making has been well established in economic literature. As current Federal Reserve Chairman Ben Bernanke observed in a 1983 paper, the costs of an ill-timed or considered investment to a firm are high, thus a business may withhold undertaking new risk and investment until the future becomes clearer.⁵ While a certain amount of economic uncertainty⁶ is always part of the risk-reward equation in entrepreneurship, policy uncertainty forces small businesses to base their investment and hiring decisions not on economic merits of market fundamentals, but on whether government policies will make their risks and investments worthwhile. As the Federal Reserve Bank of Cleveland study on policy uncertainty reported:

*“We find statistically significant negative effects of policy uncertainty on small business owners’ plans to hire and make capital expenditures....[while] we also find a large effect of the economic downturn on small business plans...**the two effects [economic uncertainty v. policy uncertainty] do appear to be independent.**”*
[emphasis added]

Since the cost of an ill-time or considered investment to a firm are high, unresolved or contentious policy issues are a significant source of policy uncertainty and reduce the willingness of small firms to undertake risks regardless of broader economic fundamentals. As the Federal Reserve Bank in Boston reported, small businesses have withheld expansion plans due to:

*...“concerns about current and future negative effects of increased uncertainty, attributable in part to failure to resolve the U.S. debt ceiling dispute promptly and the associated unclear future course of federal expenditures and taxes.”*⁷ *[emphasis added].*

Summary of Commentary on Current Economic Conditions
(The Beige Book), The Board of Governors of the Federal Reserve System,
July 27, 2011

The need for certainty for small businesses is especially important due to the disparate costs certain government policies, such as regulations, impose on small businesses. According to the United States Small

⁴ Holly Wade, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, SMALL BUSINESS PROBLEMS AND PRIORITIES 8 (August 2012), available at <http://www.nfib.com/Portals/0/PDF/AllUsers/research/studies/small-business-problems-priorities-2012-nfib.pdf>.

⁵ Ben Bernanke, IRREVERSIBILITY, UNCERTAINTY, AND CYCLICAL INVESTMENT, QUARTERLY JOURNAL OF ECONOMICS, VOL 98 85-106 (1983).

⁶ Economic uncertainty is often predicated on economic factors, such as a recession or fear of a recession reducing demand for a small businesses goods or services.

⁷ SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS BY FEDERAL RESERVE DISTRICT, THE FEDERAL RESERVE BOARD, THE BEIGE BOOK, July 27, 2011, available at <http://www.federalreserve.gov/fomc/beigebook/2011/20110727/FullReport.htm>.

Business Administration's Office of Advocacy, small businesses often face regulatory compliance costs that are on average 36 percent higher than larger firms and pay 67 percent more to comply with the tax code.⁸

Given the significant costs that government policies can impose on small businesses, advocacy associations representing small business repeatedly report that their members have withheld new investments and hiring due to uncertainty about whether and how policies will be implemented and the associated expense to their members' businesses. In its quadrennial survey of small businesses, the National Federation of Independent Business reports that, for the first time, small businesses have cited policy uncertainty as a major area of concern to their operations, with small businesses ranking government policies fourth out of 10 major areas of concern:

Problem	Rank	Percent "Critical"	Percent "Not a Problem"	2008 Rank
Cost of Health Insurance	1	52.3	6.0	1
Uncertainty over Economic Conditions	2	38.3	2.8	new
Cost of Natural Gas, Propane, Gasoline, Diesel, Fuel Oil	3	34.8	6.0	2
Uncertainty over Government Actions	4	35.1	5.9	new
Unreasonable Government Regulations	5	34.1	5.7	6
Federal Taxes on Business Income	6	29.5	6.5	3
Tax Complexity	7	28.8	6.2	5
Frequent Changes in Federal Tax Laws and Rules	8	24.0	7.0	15
Property Taxes (real, inventory or personal property)	9	24.4	8.6	4
State Taxes on Business Income	10	23.8	9.9	7

nfib.com/pnp12


The negative influence that government policies can have on small businesses has been established in a number of studies and surveys. For example, a survey of small businesses conducted by the U.S. Chamber of Commerce⁹ found that while a number of small businesses believe the economy has improved compared to earlier survey responses, this outlook has not translated into less concern about the potential impact of pending or proposed government policies on their businesses. This same survey reported:

- 52 percent of small businesses rate regulations as the greatest threat to their firm, an increase from 49 percent in January 2012.¹⁰
- 80 percent of small businesses report that taxation, regulation and legislation from Washington make it more difficult for them to hire employees.¹¹
- 73 percent of small businesses report that the health care law is an obstacle to hiring more employees.¹²

⁸ See Nicole Crain and W. Mark Crain, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS (2010), available at <http://archive.sba.gov/advo/research/rs371tot.pdf>.

⁹ United States Chamber of Commerce, Q1 Small Business Outlook Study (April 16, 2012). Note, while the survey found small business outlook on the economy has improved, only 17 percent of surveyed businesses reported the economy moving in the right direction, while 78 percent believe the economy is on the wrong track.

¹⁰ United States Chamber of Commerce, Q1 Small Business Outlook Study (April 16, 2012).

¹¹ United States Chamber of Commerce, Q1 Small Business Outlook Study (April 16, 2012).

¹² United States Chamber of Commerce, Q1 Small Business Outlook Study (April 16, 2012).

While this survey didn't specifically address whether the above mentioned policies create uncertainty for small businesses, the fact that so many small firms report concerns about policies that haven't even been fully implemented yet, such as the Patient Protection and Affordable Care Act, or which may only be in the initial planning stages, demonstrates that small businesses are highly sensitive to changes in government policies that could potentially impact their business. As this small business owner stated in testimony before the House Small Business Committee:

"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."

Craig Larsen, Founder/President, AHC Advisors, Inc.
Testimony before the Subcommittee on Economic Growth, Tax and Capital Access
December 12, 2011

The Obama Administration and Policy Uncertainty

"If the Obama Administration wants to get small business owners to expand, it needs to stop arguing that policy uncertainty doesn't matter."

Scott Shane, A. Malachi Mixon III Professor of Entrepreneurial Studies
at Case Western Reserve University, Bloomberg Businessweek
November 11, 2011

Over the last four years, whether by threatening higher taxes, adding trillions of dollars in debt to the budget, or proposing onerous and burdensome regulations, the Obama Administration has pushed an expansive policy agenda that potentially harms small firms' ability to compete with larger rivals. Here are some examples:

- A budget that proposes a \$700 billion income tax increase that would raise taxes on more than 900,000 small business owners.¹³ These higher taxes will reduce the return on small business owners' investment and raise their cost of capital.¹⁴
- A health care law that starting in 2014 imposes a \$2,000 per employee tax on certain small businesses for not providing health insurance, regardless of whether the business can afford the coverage.
- More than 165 major federal regulations costing more than \$100 million each¹⁵; with the potential for additional regulations in the future.
- A budget and fiscal policy that has already added more than \$5 trillion to our nation's debt from the time President Obama was inaugurated¹⁶ to today; ¹⁷ increases debt more in future years; and which,

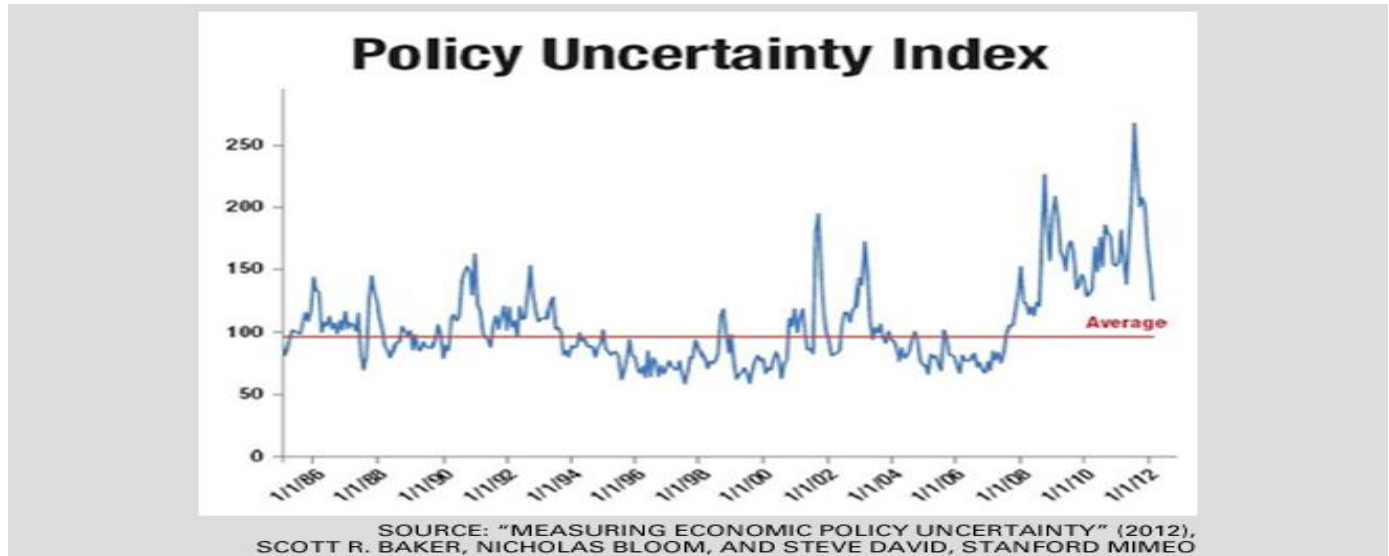
¹³ Memorandum from Thomas A. Barthold, Staff Director, Joint Committee on Taxation, United States Congress, to redacted recipients (June 18, 2012), available at http://waysandmeans.house.gov/uploadedfiles/jct_memo_on_impact_of_tax_hikes_on_flow-through_businesses_061812.pdf. Approximately 71 percent of small business firms are organized as pass-through entities where income earned from the business is passed through to the owners of the business and is taxed at individual income tax rates. This contrasts with businesses organized as C corporations where the entity itself is subject to income taxation. Robert Carroll & Gerald Prante, ERNST & YOUNG, THE FLOW-THROUGH BUSINESS SECTOR AND TAX REFORM i, 2 (April 2011).

¹⁴ Douglas Holtz-Eakin & Ike Brannon, AMERICAN ACTION FORUM, THE TAXATION OF SMALL BUSINESS: PASS-THROUGH ENTITIES 3 (July 1, 2012), available at <http://americanactionforum.org/sites/default/files/Pass%20Thoughts.pdf>.

¹⁵ <http://www.gop.gov/policy-news/12/01/31/regulation-nation>.

according to the Congressional Budget Office¹⁸, leaves our nation at risk of a sudden fiscal crisis all of which could impose even higher taxes on small businesses than those proposed in the Obama Administration's budget.

The cumulative effect of these proposals can be measured not only in their potential direct costs to the economy, but also by how they influence small business sentiment and decision making. The University of Chicago Booth School of Business uncertainty study created a "Policy Uncertainty Index" to measure how much the mere threat of onerous government policies influences business sentiment. Their index¹⁹ (below), shows how much policy uncertainty has grown since President Obama took office in 2009.



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However, despite the acknowledged disparate impacts government policies impose on small businesses and the growing body of research, surveys and testimonials from small businesses explaining how policy uncertainty is bad for small business, bad for the economy, and bad for job creation, the Obama Administration continues to argue that policy uncertainty doesn't exist.²¹

The Cost of Uncertainty to the Economy

What is the cost of government-induced policy uncertainty to small businesses, job growth and the economy? The policy uncertainty studies by the Federal Reserve Bank of Cleveland, the University of Chicago Booth School of Business and the Federal Reserve Bank of San Francisco have identified and

¹⁶ <http://www.treasurydirect.gov/govt/reports/pd/mspd/2009/opds012009.pm>.

¹⁷ <http://www.treasurydirect.gov/govt/reports/pd/mspd/2012/opds082012.pm>.

¹⁸ THE CONGRESSIONAL BUDGET OFFICE, THE 2012 LONG-TERM BUDGET OUTLOOK 4, (June 2012), available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/06-05-Long-Term_Budget_Outlook_2.pdf.

¹⁹ According to the study's authors, the Index of Policy-Related Economic Uncertainty is composed of 4 series: monthly news articles containing uncertain or uncertainty, economic or economy, and policy relevant terms (scaled by the number of articles containing 'today'); the number of tax laws expiring in coming years, and a composite of interquartile ranges for quarterly forecasts of federal government expenditures and 1-year CPI from the Philadelphia Fed Survey Forecasts. (University of Chicago Policy Uncertainty Study, *supra* note 2 at Figure 1.

²⁰ <http://www.freeenterprise.com/regulations/yes-policy-uncertainty-does-matter>.

²¹ <http://www.politico.com/news/stories/1011/66687.html>, and <http://www.treasury.gov/connect/blog/Pages/Is-Regulatory-Uncertainty-a-Major-Impediment-to-Job-Growth.aspx>.

quantified the effects of policy uncertainty on small businesses, establishing a clear link between uncertainty created by government policies and reductions in economic growth, business investment, and job creation.

“Greater policy uncertainty in 2010 lowered GDP by 1.4 percent and employment by about 2.5 million,” and “in the Summer of 2011, hiring by small businesses would have been 6 percentage points higher if it were not for policy uncertainty.”

Economic Policy Uncertainty and Small Business Expansion
The Federal Reserve Bank of Cleveland Study

“...restoring 2006 levels of policy uncertainty [when uncertainty was closer to its historical average] would increase industrial production by 4 percent and employment by 2.3 million.”

Is Policy Uncertainty Delaying the Recovery
Stanford University Study²²

“Our statistical model suggests that uncertainty has pushed the unemployment rate up at least one percentage point in the past three years [since 2009].”

Uncertainty, Unemployment and Inflation
Federal Reserve Bank of San Francisco²³

Again, while there are many factors that influence economic growth and output, and many small businesses have cited issues other than policy uncertainty as their greatest concerns, as the above studies demonstrate that policy uncertainty does result in negative economic consequences. Minimizing those consequences is the final subject addressed in this report.

Providing Certainty to Small Businesses

“...the vast majority of small businesses are still looking for the government to get out of the way and for more certainty as opposed to more government assistance.”

Q1 Small Business Outlook Study
United States Chamber of Commerce
April 16, 2012

While the Obama Administration’s government-induced policy uncertainty agenda is a significant problem holding back small business investment, job creation and overall economic growth, Republicans are offering solutions.

Over the last two years, the House Small Business Committee and congressional Republicans have worked to identify those federal government policies that create uncertainty for small businesses, while offering solutions that will provide small businesses the policy clarity necessary for them to run their businesses, invest, grow and create jobs. A sampling of this activity is listed below.

²² Scott Baker, Nick Bloom, Steven Davis, IS POLICY UNCERTAINTY DELAYING THE RECOVERY?, STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH, (March 2012), available at http://siepr.stanford.edu/?q=/system/files/shared/pubs/papers/briefs/pb_march_2012.pdf.

²³ San Francisco Fed Study, *supra* note 3 at 1.

Small Business Committee Hearings Addressing Policy Uncertainty

Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base

Full Committee

Thursday, September 20, 2012

Adding to Uncertainty: Small Businesses' Perspectives on the Tax Cliff

Subcommittee on Economic Growth, Tax and Capital Access

Thursday, September 13, 2012

Planning for the Death Tax: Can Small Businesses Survive?

Subcommittee on Economic Growth, Tax and Capital Access

Thursday, May 31, 2012

The Tax Outlook for Small Businesses: What's on the Horizon?

Full Committee

Wednesday, April 18, 2012

Field Hearing in Colorado: The Health Care Reform Law: Its Present and Future Impact on Small Businesses and Job Creation

Subcommittee on Investigations, Oversight and Regulations

Friday, March 16, 2012

Field Hearing in Illinois: Is Uncertainty Contributing to the Jobs Crisis: The Views of Local Illinois Small Businesses

Subcommittee on Economic Growth, Tax and Capital Access

Monday, December 12, 2011

Small Businesses and PPACA: If They Like Their Coverage, Can They Keep It?

Subcommittee on Healthcare and Technology

Thursday, July 28, 2011

Bills Passed the United States House of Representatives

The House of Representatives has passed a number of legislative proposals that seek to provide solutions to difficult policy issues while providing more long-term policy certainty to small businesses. A sampling of the bills the House of Representatives has passed are listed below.

Tax Certainty:

H.R. 8, the Job Protection and Recession Prevention Act: Extends the 2001 and 2003 Tax Cuts. This legislation rejects the Obama Administration's proposed \$700 billion tax increase, which would raise taxes

on more than 900,000 small businesses. (Passed the House of Representatives on 8-1-12, Roll Call # 545;²⁴ Veto Threat by President; No action taken in Democratic-controlled Senate).

Regulations:

H.R. 527, the Regulatory Flexibility Improvements Act: Requires federal agencies to not only calculate the costs of proposed regulations to small businesses, but also to examine less costly alternatives. (Passed the House of Representatives on 12-1-2011, Roll Call #880;²⁵ No action taken in the Democratic-controlled Senate).

H.R. 10, the REINS Act: Requires Executive and Congressional approval for all major regulations costing more than \$100 million. As stated earlier in the report, it can take a great deal of time for small businesses to understand the true costs and implications of new government policies to their businesses. (Passed the House of Representatives on 12-7-2011, Roll Call # 901;²⁶ No action taken in Democratic-controlled Senate).

H.R. 4078, the Red Tape Reduction and Small Business Job Creation Act: Prevents government bureaucracies from issuing major regulations for two years, or until the nationwide unemployment rate declines to 6.0 percent or below. (Passed the House of Representatives on 7-26-12, Roll Call # 536;²⁷ No action taken in the Democratic-controlled Senate).

Deficits and Debt:

H.R. 2560, the Cut, Cap, and Balance Act: Requires Congress to make discretionary and mandatory spending cuts in 2013, creates an automatic spending cap that is triggered if federal spending is misaligned with average revenue, and encourages states to ratify a Balanced Budget Amendment to the U.S. Constitution (Passed the House of Representatives on 7-19-2011, Roll Call # 660;²⁸ Veto Threat by President, Motion to Proceed Defeated in the Democratic-controlled Senate on 7-22-2011, Roll Call # 116²⁹).

H.Con.Res. 112, the FY 2013 Budget: Reduces baseline government spending by \$5 trillion over ten years through reforms in entitlement programs; hard caps on discretionary spending; repeal of the President's health care law, including its \$700 billion in cuts to Medicare; while extending all of the tax relief provided to the America people and small businesses. The only legislative proposal that makes a serious attempt to address and fix the long-term fiscal challenges facing our nation and forces the government to rely on spending cuts rather than tax increases to shrink the deficit. (Passed the House of Representatives on 3-29-12, Roll Call #151;³⁰ The Democratic-controlled Senate has not produced its own budget in more than three years).

Health Care:

H.R. 2, the Repealing the Job Killing Health Care Law Act: Repeals President Obama's health care law and thus rescinds its onerous \$2,000 per employee tax on small businesses that can't afford health insurance

²⁴<http://clerk.house.gov/evs/2012/roll545.xml>.

²⁵<http://clerk.house.gov/evs/2011/roll880.xml>.

²⁶<http://clerk.house.gov/evs/2011/roll901.xml>.

²⁷<http://clerk.house.gov/evs/2012/roll536.xml>.

²⁸<http://clerk.house.gov/evs/2011/roll606.xml>.

²⁹http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=112&session=1&vote=00116

³⁰<http://clerk.house.gov/evs/2012/roll151.xml>.

coverage. (Passed the House of Representatives on 1-19-2011, Roll Call # 14;³¹ No action taken in the Democratic-controlled Senate).

Sequestration:

H.R. 5652, the Sequestration Replacement Reconciliation Act: Averts the January 2, 2013 across-the-board sequestration cuts to our armed forces and key priorities, reduces the deficit and fosters a better environment for job creation. The legislation would provide mandatory spending reductions, the savings from which (\$78 billion) would be used to avert the across-the-board sequestration cuts to key programs. (Passed the House of Representatives on 5-10-2012, Roll Call # 247;³² No action taken in the Democratic-controlled Senate).

H.R. 6365, the National Security and Job Protection Act: Repeals the January 2, 2013 across-the-board cuts in defense and non-defense discretionary spending through either the enactment of H.R. 5652 (above) or any other legislative proposal that provides equal budget savings over the next five years. Also requires the President to submit a legislative plan to avert scheduled sequestration cuts with alternative reductions. (Passed the House of Representatives on 9-13-12, Roll Call # 577;³³ No action taken in the Democratic-controlled Senate).

“We have a small business in Pennsylvania that [we] would love to grow and have the opportunity to do so, however, the uncertainty of Washington has caused us to remain at our current level of operations.”

**Jammi Schaible, V-Talese Inc.
Souderton, Pennsylvania.**

**Submitted to the House Small Business Committee “Open Mic”
Web Forum**

These legislative proposals are only a sampling of a number of bills House Republicans have proposed and passed to provide long-term policy certainty to our nation’s small businesses. To learn more about how Republicans are fighting for small business job creators, please visit: www.smallbusiness.house.gov.

³¹ <http://clerk.house.gov/evs/2011/roll014.xml>

³² <http://clerk.house.gov/evs/2012/roll247.xml>

³³ <http://clerk.house.gov/evs/2012/roll577.xml>