Entrepreneurship in the New Economy

Testimony by
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Before the
Committee on Small Business
U.S. House of Representatives

The Honorable Nydia Velazquez, Chairwoman
The Honorable Blaine Luetkemeyer, Ranking Member

November 3, 2021

Chairwoman Velazquez, Ranking Member Luetkemeyer, and Members of the Committee, thank you for hosting this important hearing today on "Entrepreneurship in the New Economy." The Small Business & Entrepreneurship Council (SBE Council) is pleased to submit this testimony.

My name is Raymond J. Keating, and I am the chief economist for SBE Council, and over the years have penned a wide range of studies related to entrepreneurship and the economy, and as an author and publisher of my own books have firsthand experience as an entrepreneur. Also, for a decade, I taught a variety of courses to MBA students, including, for example, advanced innovation and entrepreneurship.

I am honored to be a part of this hearing today representing SBE Council, an advocacy, research and education organization dedicated to promoting entrepreneurship and protecting small businesses. For more than 26 years, SBE Council has worked to strengthen and improve the ecosystem for startups and small business growth. SBE Council is engaged at the local, state, federal and international levels on policies that enhance competitiveness, and improve the environment for business start-up and expansion, and economic growth.

Vital Entrepreneurship

Why does entrepreneurship matter? Entrepreneurs take on risk and uncertainty in order innovate, introduce new products and services, and find better ways to do things, and by doing so, they boost productivity, enhance competition and choice, fuel economic growth, and create new jobs. Indeed, among the competitive advantages that Americans have in the global marketplace is our entrepreneurial tendencies or entrepreneurial drive arguably is paramount.

Of course, there are all kinds of entrepreneurs contributing to our economy. Economist Joseph Schumpeter emphasized the innovative entrepreneur who drives the process of "creative destruction," whereby new products and industries overturn the old. In this sense, the entrepreneur is a creator. Other entrepreneurs, as economist Israel Kirzner noted, for example, discover and act on existing, but heretofore-unnoticed profit opportunities. They see markets or niches not being served, and step in to do so.

Schumpeter and Kirzner were 20th century economists, but the term "entrepreneur" has been around since the 13th century. And it was the early-19th century economist Jean-Baptiste Say who gave intellectual heft to the word, by identifying entrepreneurs as those who create value by shifting resources from less productive to more productive undertakings.

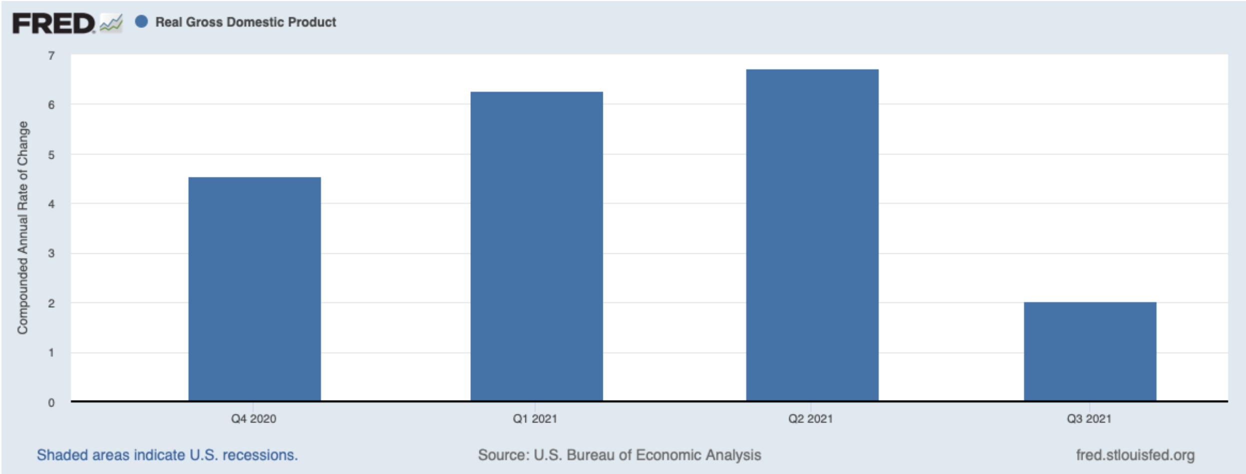
And the case can be made that the entrepreneur has only become more essential to our well-being in this 21st century economy that is so dynamic and fast-changing given how technology has empowered individuals, expanded competition, and opened new opportunities from our local towns to reaching customers globally.

Entrepreneurs, along with the investors who are essential for funding startups and business growth, are central to the economic, income and employment growth we all want to see happen.

State of the Economy

As for our economy, where do we stand as we work to emerge from a pandemic that has taken such a heavy toll in terms of lost lives, illnesses, and severe economic costs?

Unfortunately, as I noted in a recent SBE Council analysis, the recovery from the pandemic slowed dramatically in the third quarter of this year. Real GDP (on a seasonally adjusted basis at an annual rate) grew at a mere 2.0 percent in the third quarter, down from 6.7 percent in the second quarter and 6.3 percent in the third.



Source: Federal Reserve Bank of St. Louis, FRED

The consumer pulled back, with real personal consumption expenditures (PCE) growing by only 1.6 percent, including spending on goods declining by 9.2 percent thanks to a drop off of 26.2 percent in spending on durable goods.

As for business investment, which is essential for current and future economic growth, real nonresidential business investment in the third quarter grew by only 1.8 percent. That was down from 12.9 percent in the first quarter and 9.2 percent in the second quarter. Investment in equipment declined by 3.2 percent in the third quarter, with structures investment dropping by 7.3 percent. The lone area of strength for business investment was a 12.2 percent increase in intellectual property products, including software.

Nonresidential (or housing) investment dropped by 7.7 percent in the third quarter, and that came after a decline of 11.7 percent in the second quarter. Of course, housing had been running hot in the second half of 2020 and into early 2021.

Trade was a mixed bag. Real exports declined by 2.5 percent in the third quarter. In fact, exports have fallen in two of the last three quarters. As for imports, they grew overall by 6.1 percent (keep in mind that nearly all imports are inputs to U.S. businesses), but while goods imports declined by 0.1 percent, service imports jumped by 44.4 percent.

Finally, inflation was unmistakable. The GDP price index – one of the broadest measures of prices – jumped by 5.7 percent in the third quarter, after annualized increases of 6.1 percent in the second quarter and 4.3 percent in the first quarter.

The most recent GDP data is troubling. By the second quarter of this year, entrepreneurs, investors, businesses and workers worked to get the economy (that is, our economic output) back to where it was pre-pandemic. However, we still face the task of getting back to where we should be, given lost growth, and then maintaining strong growth thereafter.

Unfortunately, two percent growth is anemic under *normal* circumstances, given that the U.S. economy on average should be growing at better than 3 percent and during non-recession periods at better than 4 percent (based on post-World War II data).

At 2 percent growth, U.S. economic under-performance will be extended far into the future. We obviously need to do much better. That leads us to consider the state of entrepreneurship and small business, which stand as key sources of innovation, growth and job creation.

State of Entrepreneurship and Small Business

We know from various surveys that the pandemic has had a devastating effect on small businesses, with estimates of closed small businesses at various times over the past 20 months ranging from hundreds of thousands into the millions. That, of course, reflects the fact that the U.S. very much is a small business economy, with Census Bureau data telling us that the share of U.S. businesses with fewer than 20 workers stands at 98.0 percent, and the share with fewer than 10 employees registers 96.0 percent.

As for data telling us the very latest on the state of entrepreneurship, it is sparse. For example, the Census Bureau data has a multi-year lag. But what we can see from the Census data is that entrepreneurship was, at best, lagging in recent years.

The number of businesses with employees in the U.S. – that is, employer firms – registered just over 6 million in 2007 and stood at just over 6 million in 2018. So, there in effect was no growth for over a decade, which ran contrary to the rather steady growth witnessed over the previous 20 years.

As for nonemployer businesses, that is, the one-person business, they registered 21.7 million in 2007, and had risen to 26.5 million in 2018. That's certainly positive and welcome. However, it also should be noted that from 1997 to 2007, nonemployer businesses grew by 41 percent, but from 2007 to 2018, growth registered 22 percent. So, growth did slow markedly.

The point here is that entrepreneurship was lagging before the pandemic.

Another view on entrepreneurship comes from self-employment data courtesy of the U.S. Bureau of Labor Statistics data. And these numbers, fortunately, are updated with each month's employment report, so we can get some insights since the pandemic hit. There actually are two sets of data, that is, unincorporated self-employed and incorporated self-employed.

In recent times, *incorporated* self-employed fell from 5.78 million in 2008 to 5.13 million in 2011 with the Great Recession. It climbed back to 5.85 million in 2017.

So, it took nearly nine years for the number of incorporated self-employed to get back to its 2008 level. That was followed by no growth in 2018. But increases in the following two years took the number of incorporated self-employed to 6.28 million in 2020.

However, from October 2020 to September 2021, the monthly tallies (not seasonally adjusted) ran lower than the same month in the previous year. So, we've seen a decline in self-employment by this measure over the past year.

There's more to the self-employment story.

Over the longer term, the number of *unincorporated* self-employed declined from 10.59 million in 2006 to 9.36 million in 2014. Uneven growth resumed, with the level hitting 9.71 million in 2018. However, that was followed by marked declines in 2019 and 2020. The 2020 level of 9.25 million was the lowest since 1983. Again, this is not surprising given the pandemic.

However, over the past five months of data, from May to September 2021, we've seen a notable leap up in the number of unincorporated self-employed (seasonally adjusted data.) The numbers jumped from 9.65 million in April to 10.02 million in May, dipping below 10 million once more in June, but then staying above 10 million during July, August and September, with the September number coming in at 10.14 million.

Consider that the last time prior to these last few months that the number of unincorporated self-employed were above 10 million was in 2008.

Now, let's combine incorporated and unincorporated data to get a broader, or more complete, look at the trend in self-employment.

The *total* number of self-employed (incorporated plus unincorporated) hit 16.15 million in 2007, but then declined for five years, registering 14.72 million in 2013. Some growth resumed, with the total climbing back to 15.72 million in 2019, and then dropping to 15.54 million in 2020. So, as of 2020, the level of total self-employed remained below the 2007 recent high.

As for the most recent month's data (not seasonally adjusted), the tally in September 2021 was 16.38 million, which was up from September 2020's 15.82 million, and from the 15.9 million in pre-pandemic September 2019.

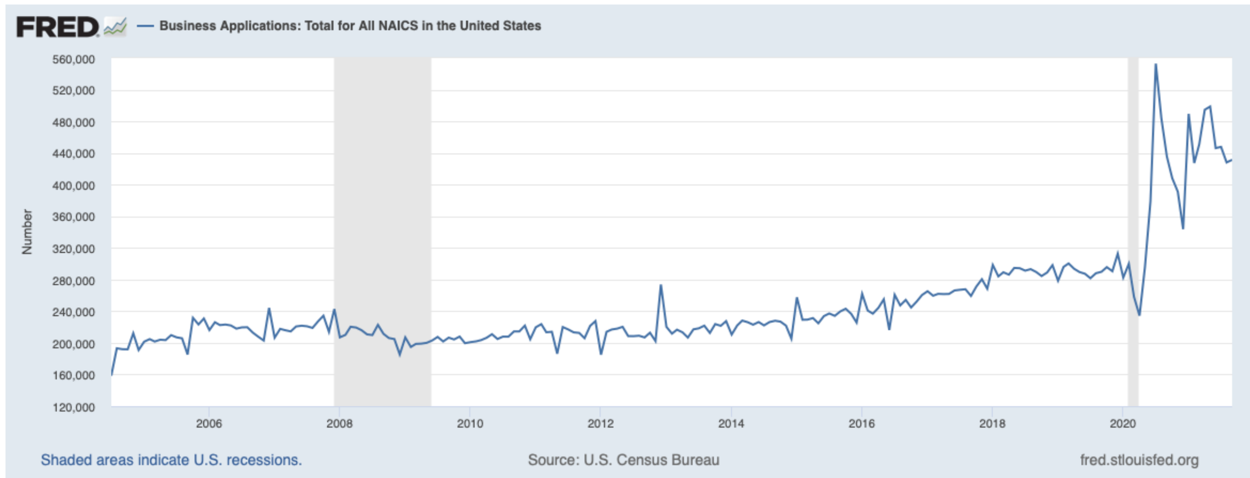
Obviously, seeing some life in the self-employment totals is welcome. But perhaps the key takeaway from the self-employment data is that the September 2021 number was essentially at the same level as registered in September 2007 (16.2 million). That's fourteen years of no growth. Again, we need to do better.

Another set of data has been a beacon of hope regarding entrepreneurship.

The U.S. Census Bureau reports on business applications for tax ID numbers. These applications serve as an indicator for future actual business formations. While this data set only goes back to the early 2000s, there has been a strong relationship between these applications and business formations happening sometime over the coming four to eight quarters.

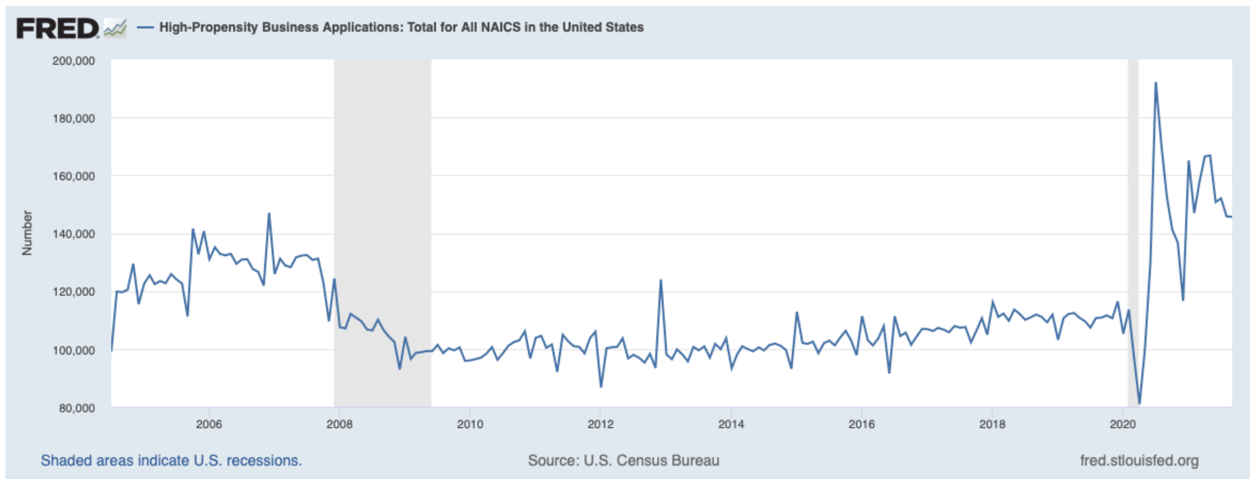
After suffering big declines when the pandemic first struck, the number of business applications (seasonally adjusted) skyrocketed beyond where they had been prior to the pandemic. As noted

in the latest report from the U.S. Census Bureau, business applications for tax ID numbers registered 431,381 in September. That marked 16 straight months of applications running far ahead of where they had been before the pandemic struck. (See the following chart.)



Source: Federal Reserve Bank of St. Louis, FRED

For good measure, high-propensity business applications – that is, applications that have a high likelihood of turning into businesses with employees – also continued to run well ahead of pre-pandemic levels, coming in at 145,628 in September 2021. (See the following chart.)



Source: Federal Reserve Bank of St. Louis, FRED

The data on business applications provide hope for a recovery in entrepreneurship, which would feed into economic recovery and expansion. The historical relationship indicates that there is reason for hope here, although it also must be noted that a pandemic economy is uncharted waters, and with so many people losing their jobs, one has to wonder how many filed business applications out of desperation or as some kind of insurance.

At the same time, the expansion of the “gig” economy would support this data, as would more people positively considering entrepreneurship due to their pandemic experiences. Speaking of his own entrepreneurial journey, Walt Disney once said, “When you can’t get a job, you start your own business.”

Challenges for Entrepreneurs and Small Businesses

Among the challenges faced by entrepreneurs, some are evergreens, while others are specific to our current situation.

For example, a key evergreen is financing one’s enterprise. At the very beginning, entrepreneurs start with their own savings, and they tap family and friends for funding. But at various stages of growth, they need to gain the interest of investors, that is, the investors who have the funds to invest. Quite simply, it is wealthy people who have the wherewithal to supply the financial capital that entrepreneurs need to grow their businesses, again thereby driving economic and job growth. Depending on the stage of development, angel investors or venture capitalists are needed to grow businesses. So, contrary to widespread assumptions, just as workers and business owners need each other to make a business function and succeed, they also need individuals with the ability and willingness to lend and invest.

But then there are, as mentioned, challenges specific to our current situation, such as labor shortages, supply chain challenges and inflation.

Let’s first consider the labor shortage issue by putting it in the context of the current overall labor market.

First, the latest MetLife/U.S. Chamber of Commerce survey of small businesses, conducted between September 30 – October 7, 2021, is one of many surveys and reports on hiring challenges for small businesses. It found:

- 44% of small businesses are finding it harder to fill open positions (up 10 percentage points since June).
- 36% of small businesses are actively looking, recruiting, interviewing and hiring (up 3 points since June).
- 49% of those employers actively engaged in the hiring process are struggling to find candidates with the skills they need (up 15 points since June).

Given these problems, let’s consider the latest employment report from the U.S. Bureau of Labor Statistics. And we must note that this monthly employment report actually is two reports, or at least based on two separate surveys. The BLS notes:

“This news release presents statistics from two monthly surveys. The household survey measures labor force status, including unemployment, by demographic characteristics. The establishment survey measures nonfarm employment, hours, and earnings by industry.”

So, the oft-cited payroll numbers come from the establishment survey, while the unemployment rate is from the household survey. However, these numbers need to be put in perspective with other data points that actually tell a more complete story on jobs for the month.

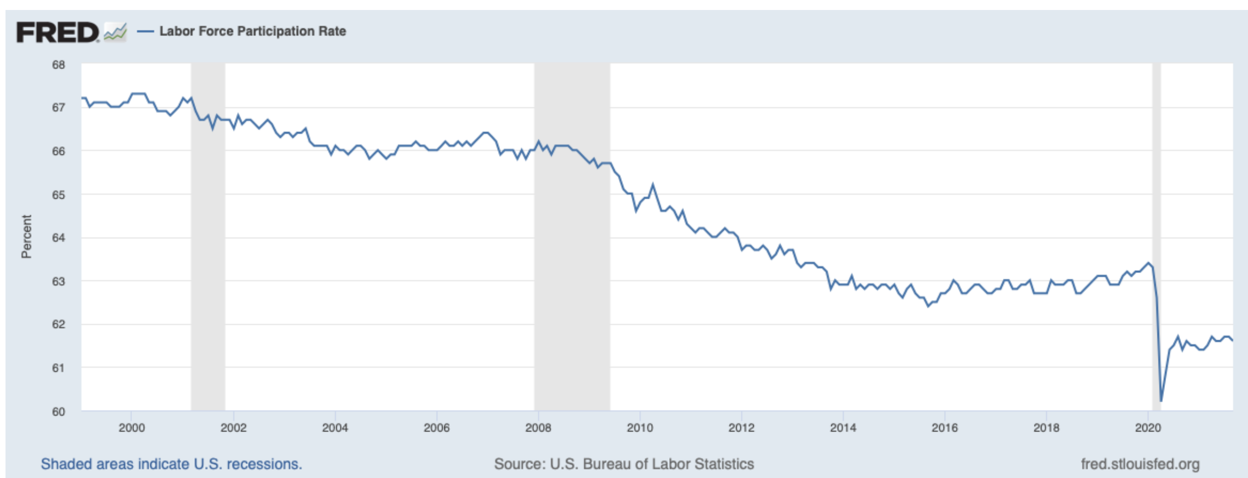
The establishment survey estimated that nonfarm employment increased by 194,000 in September 2021. That was considered lackluster given the number of jobs we still need to regain given the pandemic economy losses. Meanwhile, the household survey showed a large drop in the unemployment rate – from 5.2 percent in August to 4.8 percent in September. The unemployment rate, however, should not be taken at face value. The underlying numbers must be examined.

The household survey – which tends to better capture startup and small business activity – pointed to an employment gain of 526,000 in September, far more than the establishment survey. However, at the same time, the labor force in September shrank by 183,000. That means that the decline in the unemployment rate in September was partially positive (the gain in employment) and partially a negative (the decline in the labor force).

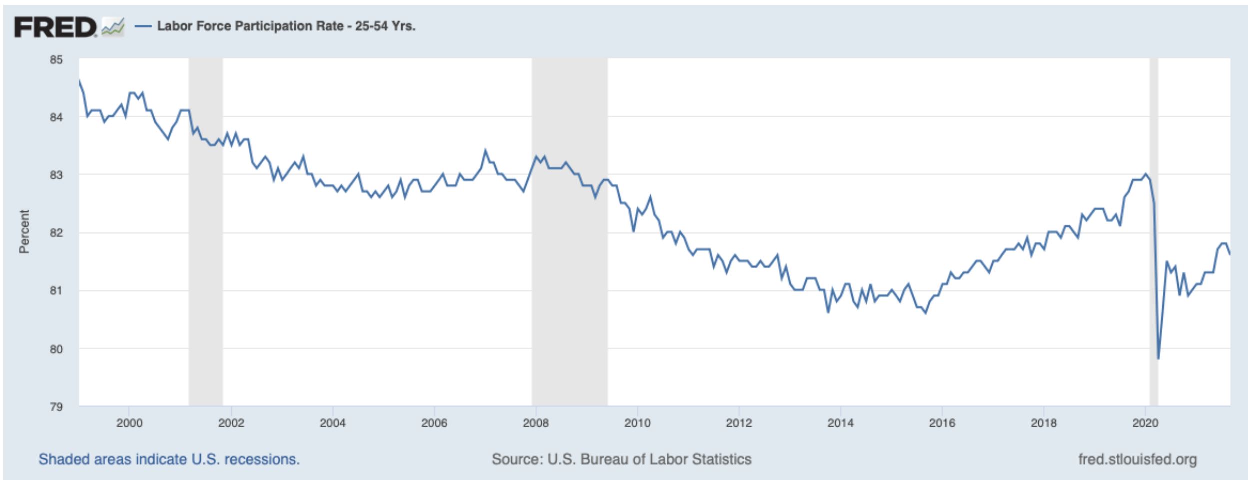
So, the employment-population ratio improved from 58.5 percent in August to 58.7 percent in September. But at the same time, the labor force participation rate declined slightly, from 61.7 percent in August to 61.6 percent in September.

We often hear people judging how tight the labor market is by the unemployment rate. But that misses too much, including the number of people not in the labor force. Looking at the labor force participation rate and employment-population ratio is more informative.

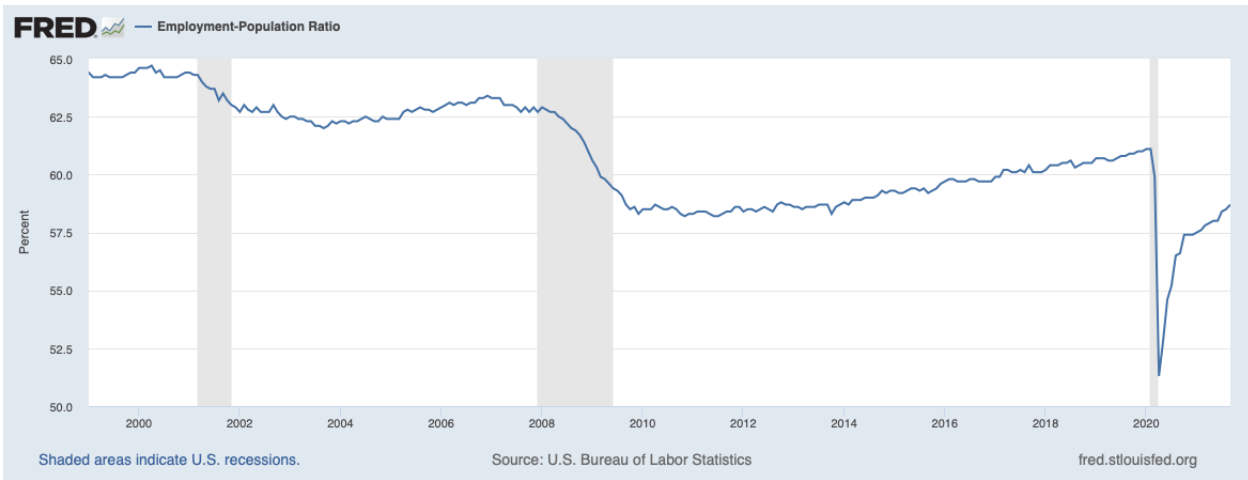
The trends shown in the following four charts show that the U.S. economy still has a long way to go in terms of getting the labor force participation rates for the general working age population, and for the key working-age group of 25-to-54 year olds, with the same going for the employment-population ratio.



Source: Federal Reserve Bank of St. Louis, FRED



Source: Federal Reserve Bank of St. Louis, FRED



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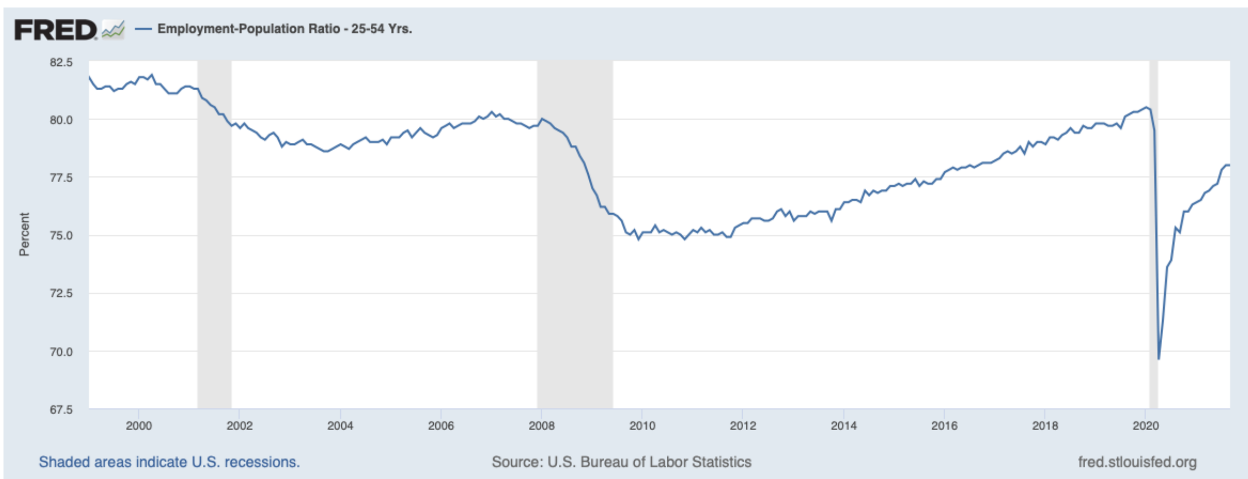

Source: Federal Reserve Bank of St. Louis, FRED

Based on the charts above, we can see how businesses can be challenged not by a tight labor market *per se*, but by a labor shortage. It's not about not having enough people to work – well, to a certain point for the near term – but more about people apparently not willing to work. Neither the labor force participation rate nor the employment-population ratio – total and for those in prime working years – have climbed back to where they were prior to the pandemic, nor to where they were prior to the Great Recession.

And then we come to supply chain matters. They are real and, for many industries, significant.

The latest edition of the U.S. Census Bureau's Small Business Pulse Survey made clear that supply-chain challenges for small businesses have actually risen. Consider, for example, that the percent of small business owners in the latest survey (collected over October 11-17) facing delays/difficulties with domestic suppliers registered 45 percent. Three months earlier, that stood at 38.2 percent. Also, 19.7 percent cited delays/difficulties with foreign suppliers in the latest survey compared to 15.6 percent three months earlier.

The debate certainly rages over how long supply chain issues will run and how severe they will be, with Moody's pointing to more problems while JP Morgan's Jamie Diamond, noting, "I think great market systems will adjust for it like companies have." I think Diamond is correct. After all, market signals – such as prices, profits and losses – guide resource allocation. But the fact that these troubles actually have increased, as opposed to being remedied and the situations improving, speaks to just how disrupted the economy has been by this pandemic, and the significant amount of work that lies ahead in terms of returning to economic normalcy.

As for inflation, the numbers are undeniable.

The latest Beige Book from the Federal Reserve – an assessment of the economy based on interviews with business contacts, economists, market experts, and so on – noted the following:

> "Most Districts reported significantly elevated prices, fueled by rising demand for goods and raw materials. Reports of input cost increases were widespread across industry sectors, driven by product scarcity resulting from supply chain bottlenecks. Price pressures also arose from increased transportation and labor constraints as well as commodity shortages. Prices of steel, electronic components, and freight costs rose markedly this period. Many firms raised selling prices indicating a greater ability to pass along cost increases to customers amid strong demand."

I have already noted that the GDP price index – a very broad price index – shows inflation, and so does Consumer Price Index (CPI). The latest report from the U.S. Bureau of Labor Statistics showed that CPI inflation ran at 0.4 percent in September, up a tick from the 0.3 percent in August, but down some from what prevailed from March to July (in the 0.5 percent to 0.9 percent range). Over the past year, inflation ran at 5.4 percent. And over the past six months,

inflation ran at an annualized rate of about 7 percent. That slowed to 4.8 percent over the past three months.

Inflation, which is the ongoing rise in the general price level, creates all kinds of problems. The woes of high inflation include greater uncertainty; more price volatility (in a high inflation environment, prices not only rise but changes tend to be volatile); increased costs, including for small businesses, such as higher interest rates and rising input prices; a diminished value of the dollar (for example, the dollar buys less today that it did a month ago); and higher taxes, as many taxes, such as capital gains levies, are not indexed for inflation.

Looking ahead, at best, this current inflation challenge will last for however long it takes for the economy to work through various shortages, such as on the labor and supply chain fronts. At worst, inflation will take firmer hold due in part to the loose monetary policy that the Federal Reserve has been running since 2008, thereby needing concerted policy actions to get under control, such as the Fed reining in the money supply while fiscal policy would need to move in a more pro-growth direction (more on this later). That was the policy mix in the 1980s that defeated inflation.

Expanding Opportunities for Entrepreneurs and Small Businesses

While the challenges are many for entrepreneurs and small businesses coming out of a pandemic, there also are expanding opportunities. Let's consider two areas generating greater opportunity for entrepreneurs, small businesses and their employees.

The first is technology. Whether it be in terms of generating new products, improving and enhancing production, and/or expanding distribution (from marketing to delivery), technological advancements in such areas as computer, digital and broadband technologies, for example, have served to expand opportunities for entrepreneurs. Social media, for example, has served to create and transform businesses.

SBE Council has long examined the effects of such technological changes on entrepreneurs and small businesses. Social media options, such as Facebook, Twitter and Google, have been critical to entrepreneurs and small businesses, especially in terms of reaching new customers and maintaining communications with customers in cost-effective ways.

Far too many small businesses that offer valuable goods or services have struggled or failed because they failed to connect with their niche market or target audience. Or, they may have failed because the fell short in maintaining communications with customers. Entrepreneurs, who understand that marketing is essential, including advertising, have been constrained by the amount of dollars available, and struggled with how best to spend the limited marketing dollars they have. Helping entrepreneurs and small businesses overcome these challenges in recent times has been an assortment of technological developments, which are ongoing, including social media.

Consider key findings from a September 2019 SBE Council **survey** on the importance of online advertising:

• “[F]or startups and new businesses, the availability of online advertising was identified by entrepreneurs as a key factor in launching their enterprises, with 80% agreeing that: ‘The ability to reach customers and potential customers was an important factor in starting my business.’”

• “Of the startups surveyed in our report, 90% agree that ‘Online advertising has provided my business with an affordable option to launch and/or grow my business,’ and 86% agree that the method is ‘important to my business survival and growth.’”

• “Small business owners report that they have also boosted the competitiveness of their businesses from new revenues generated by online advertising, which they say is extremely effective at driving new sales. In fact, 73% of small businesses stated that without online advertising ‘it would impact my ability to effectively market my products and services and to grow my business.”

• “While most of the small businesses in the survey use a mix of online and traditional advertising like newspaper ads, mailings, radio, television and other methods (29% use online advertising exclusively and 71% use a mix), survey respondents pointed to key benefits of online advertising compared to traditional advertising such as: finding new customers leading to new sales (89%), the ability to target their intended customer base more effectively (88%), identifying new customers and prospects (87%), saving time on labor with regard to research, targeting, and other aspects of selecting appropriate methods for advertising my products/services (84%), they can more effectively compete with other businesses including larger businesses (82%), and increased value and higher return on investment on ad dollars spent (81%).”

• “Technology, obviously, has become an entrepreneur’s best friend. New innovations continue to produce cutting-edge tools for entrepreneurs to launch and grow their businesses. Thanks to the internet and cost-effective methods that help entrepreneurs target and reach potential customers, small business owners are experiencing very positive returns through online advertising, according to the results of our survey.”

Also, in February 2021, which was a year into the pandemic, the Small Business Roundtable and Facebook released the “U.S. State of Small Business: 2020 – A Challenging Year for SMBs.” Among the findings were:

• “34% of businesses have increased their use of online or digital tools since the pandemic began, consistent with other research (Deloitte 2020).”

• “In addition, more businesses started selling online for the first time. The proportion making no sales through digital channels in the past 30 days fell from 35% before COVID-19 to 13% in the 30 days prior to the December survey, and the proportion making 100% of their sales online rose from 13% to 20%.”

• “Many businesses have also used digital channels to advertise. 57% of businesses reported that they use social media to advertise, second only to the number using word of mouth (59%).”

And as for opportunities expanding in terms of distribution of products for entrepreneurs and small businesses, consider how various online businesses have become, in effect, distribution partners with small companies.

For example, being able to work with the largest online retailer, Amazon.com, serves as a major benefit for small businesses in terms of selling and delivering products. On February 3, 2021, Amazon.com reported: "[W]e are supporting the rapid growth of more than 1.7 million small and medium-sized businesses (SMBs) around the world that are selling their products in our store. SMBs now makeup close to 60% of the sales in our store, and they have created more than 2.2 million jobs globally as a result of selling on Amazon. In fact, SMBs from all 50 states that sell with Amazon are more than twice as likely to see 25-50% hiring growth compared to those that do not, research by IDC."

I also can speak firsthand as to how such technology has been essential for me as an entrepreneur, that is, as the author and indie publisher of thriller and mystery books.

For example, Amazon makes it easy to publish and distribute my books through its Kindle Direct Publishing service. It's free and allows me to publish my novels as eBooks and paperbacks, and now they have just added hardcover options. The entire process is intuitive and user-friendly, including uploading the books, setting prices, and so on. And once available at Amazon.com, this author and indie publisher effectively has the same online "shelf space" as the genre's most successful writers. And not only does Amazon handle the sales and delivery of my books ordered on Amazon.com, but I am also able to keep a minimal stock of books on hand in my home office for sales of signed books through my own website. There also are innovative ways for my readers to get other readers interested, such as the ability to easily send the Kindle editions of my books to others as gifts via the "Buy for Others" button on the Kindle page at Amazon for each book.

But as many failed small businesses can testify, it's not enough to set up shop and wait for customers. One has to get the word out, that is, marketing, including advertising, is critical. In terms of my sales, the difference has been Facebook, and the ability to target or personalize advertising in a very affordable way.

Before I started using Facebook's advertising tools, my sales were encouraging, but not exactly rocking and rolling. But once I started spending my minimal advertising dollars each month on Facebook's targeted ads, I saw a clear jump in sales. Being able to target people with interests that lined up with my books made a huge difference. And along with advertising, the Facebook page for my books, along with my personal Facebook page, serve as excellent means for staying in communication and engaged with current and potential book buyers.

In the case of technology expanding opportunity, I am one of millions of entrepreneurs and small businesses reaping the rewards.

A second major area of expanding opportunities for entrepreneurs is the international marketplace. Technology advancements coupled with economic growth abroad have opened

doors in the international arena for entrepreneurs. Keep in mind that 95 percent of the world's consumers are outside the U.S.

Consider the role that small business already plays when it comes to international trade. Many assume that international markets are the near-exclusive domain of large businesses, but that is not the case.

Based on data from the latest report from the U.S. Census Bureau, we see the following about the roles small and mid-size businesses played in international trade – overall and with the top three U.S. trading partners (Canada, Mexico and China) – in 2019.

Exporting

• Among all identified U.S. exporting firms, 76.3 percent had fewer than 20 employees, 86.3 percent fewer than 50 employees, 91.4 percent fewer than 100 employees, and 97.4 percent fewer than 500 employees.

• Among all identified U.S. exporting manufacturing firms, 56.5 percent had fewer than 20 employees, 74.1 percent fewer than 50 employees, 84.3 percent fewer than 100 employees, and 96.1 percent fewer than 500 employees.

• Among all identified U.S. firms exporting to Canada, 61.7 percent had fewer than 20 employees, 76.1 percent fewer than 50 employees, 84.1 percent fewer than 100 employees, and 94.5 percent fewer than 500 employees.

• Among all identified U.S. firms exporting to Mexico, 57.9 percent had fewer than 20 employees, 71.7 percent fewer than 50 employees, 80.3 percent fewer than 100 employees, and 92.9 percent fewer than 500 employees.

• Among all identified U.S. firms exporting to China, 53.0 percent had fewer than 20 employees, 67.6 percent fewer than 50 employees, 77.2 percent fewer than 100 employees, and 91.3 percent fewer than 500 employees.

Importing

• Among all identified U.S. importing firms, 76.7 percent had fewer than 20 employees, 86.4 percent fewer than 50 employees, 91.3 percent fewer than 100 employees, and 97.3 percent fewer than 500 employees.

• Among all identified U.S. importing manufacturing firms, 49.5 percent had fewer than 20 employees, 66.1 percent fewer than 50 employees, 77.5 percent fewer than 100 employees, and 93.7 percent fewer than 500 employees.

• Among all identified U.S. firms importing from Canada, 43.6 percent had fewer than 20 employees, 55.5 percent fewer than 50 employees, 64.9 percent fewer than 100 employees, and 83.0 percent fewer than 500 employees.

• Among all identified U.S. firms importing from Mexico, 58.6 percent had fewer than 20 employees, 68.2 percent fewer than 50 employees, 74.4 percent fewer than 100 employees, and 86.4 percent fewer than 500 employees.

• Among all identified U.S. firms importing from China, 74.6 percent had fewer than 20 employees, 84.8 percent fewer than 50 employees, 90.0 percent fewer than 100 employees, and 96.6 percent fewer than 500 employees.

The myth that imports are economic negatives must be laid to rest. Not only do imports offer more choices, improved quality and better prices for consumers thanks to added competition, for example, but keep in mind that nearly all imports are inputs to American businesses, from manufacturers to retailers. For good measure, most of those manufacturers and retailers are smaller companies.

As it becomes easier thanks to advancements and innovations in so many different areas, such as advancements in computer and online technologies, production, logistics and so on, the international marketplace promises to offer more and more opportunities for U.S. entrepreneurs, small businesses and their employees.

Pro-Entrepreneur Policy Framework

So, given these realities for our economy, entrepreneurship, challenges, and opportunities, what are the policies that make the most sense? Without getting into exact numbers and too much detail, let's hit on the key aspects of a pro-entrepreneur policy framework.

Avoid tax increases and provide tax relief.

Talk of tax increases seems to everywhere of late. So, why not raise taxes? Well, let's consider the fundamental problems with tax increases for the economy.

First, taxes drain resources from the private sector so they can be used in government. The problem here is that when resources are taken and used by government, it means they are being spent according to political incentives – such as being subject to special interest lobbying, being doled out according to the preferences of politicians, often being spent in ways that undermine work and risk taking in the economy, and being utilized to enhance power, staff and budgets in government. This, of course, means resources are being used far less efficiently than in the private sector – which in contrast is disciplined by prices, profits, losses, competition and consumer sovereignty.

Second, taxes affect incentives. Most troubling are taxes that affect incentives for the undertakings that drive economic growth, as has been emphasized here, entrepreneurship and investment, as well as working and saving. So, taxes that raise the costs and reduce the returns on such activities tend to be the most economically destructive taxes, and these include income taxes and capital gains taxes.

So, higher taxes always come with economic negatives. But raising taxes as entrepreneurs, businesses, investors and workers struggle to leave the pandemic economy behind, and get us back on a track of robust growth, is particularly misguided.

The policy focus needs to move away from counter-productive efforts to raise taxes, and instead look to providing substantive, permanent tax relief, in particular, reducing taxes that directly impact entrepreneurship and investment, namely, income, capital gains and death taxes. Again, it must be kept in mind that increased taxes on investors wind up being negatives for the entrepreneurs who need investment.

Emphasize regulatory relief, not imposing additional regulatory burdens.

While individuals, in many ways, pay the ultimate price for excessive regulation through reduced choices and higher costs as consumers, reduced incomes as earners, and fewer opportunities as workers, those costs tend to be hidden. That is, while a person can see the burden of taxes when they look at their pay stubs and see how much is drained away via income taxes; when they buy a product and pay a sales tax; or when they receive their property tax bill or note the property taxes portion of their mortgage payment, there are no obvious ways to see how regulations burden each and every one of us.

Meanwhile, large businesses most certainly see and have to directly deal with regulatory burdens. However, large firms, up to a certain point, are better able to deal with the costs of regulations, including by having staff deal with such matters, such as the legal department, or tapping legal/regulatory experts on retainer. For good measure, there are instances where large businesses actually become advocates for – or at least not opponents to – increased regulation, given that such regulations will deter new business formations in the industry and the costs will fall more heavily on small businesses. In this sense, regulations can serve as a means for protecting long-entrenched businesses, while deterring upstart competitors.

It is, in fact, small businesses that pay the heaviest price when it comes to dealing with regulatory costs. As summed up in an SBE Council report ("Regulation: Costs, Incentives and the Need for Reform"): "Assorted studies make clear the significant costs imposed by the U.S. regulatory system in terms of lost GDP, costs imposed on small businesses, declining entrepreneurship, reduced job creation, and reduced or restrained investment and productivity. Studies over the past 25 years have consistently found that the cost of regulatory compliance disproportionately affects small firms."

It also must be noted that small business owners, perhaps better than anyone else, understand the cumulative burdens of regulation. It's not just about the current regulation under consideration, but it's also about all of the previous regulations imposed and then adding new burdens. Hence, any discussion of imposing a new regulation on entrepreneurs and businesses must be put in proper context, that is, recognizing the burdens that already exist.

Indeed, as is the case with higher taxes, increased regulations always come with increased costs, but inflicting such added burdens during a period when the economy is working to emerge from the pandemic woes, again, is misguided and counter-productive.

Rather than emphasizing all kinds of ways to increase regulatory intrusions, entrepreneurship and investment would be aided by serious efforts at regulatory reform, such as sunsetting rules and regulations so that Congress is required to re-evaluate regulations after a certain period of time; and requiring congressional approval of rules and regulations to establish full responsibility for regulating to Congress.

Advance free trade.

Free trade simply means reducing government-imposed barriers and obstacles to trading across international borders. These barriers include, for example, tariffs, or taxes on imports, and quotas, or limits on certain imports. In summary, free trade reduces costs through enhanced competition and lower trade barriers; expands choices and lowers prices for consumers; keeps U.S. firms competitive; opens new markets and opportunities for U.S. goods and services; reduces costs for U.S. businesses; expands economic freedom; and feeds economic growth.

Indeed, contrary to assertions from various political corners, trade is a positive for U.S. businesses, workers and our economy. And keep in mind that total trade (exports plus imports) accounted for 30 percent of GDP in 2014 and 27.5 percent in 2018, before falling to 26.4 percent in 2019 and 23.5 percent during the 2020 pandemic year.

A vital, dynamic, growing economy is one that is open to trade, providing benefits to consumers, entrepreneurs, businesses of all sizes, and workers. We've known this since Adam Smith wrote his seminal *Wealth of Nations* in the late 18th century. On the policy front, the U.S. needs to move away from protectionist measures and aggressively move to advance free trade on all fronts. Indeed, the U.S. needs to reclaim the global leadership role it had in advancing free trade since the end of World War II, but recently abandoned.

Immigration Matters to the Economy … in a Good Way.

A constructive pro-immigration policy agenda – that is, improving and expanding avenues of immigration for those who wish to contribute by working and starting businesses while also enhancing security to keep out terrorists, et al – would make a difference in the long run in terms of meeting labor needs and advancing entrepreneurship.

Contrary to political claims, immigration is an economic plus. How so?

First, immigration allows market demands for both low-skilled and high-skilled labor to be met. That demand comes from businesses that ultimately serve consumers. As labor markets grow tighter, for example, expanded immigration is needed.

Second, other workers, including the native born, benefit as immigrants do complementary work, thereby enhancing the productivity of all workers. By the way, immigrants have higher labor force participation and employment rates than the general population.

Third, given that immigrants are obvious risk takers (leaving for another country is serious risk taking), it's not surprising that immigrants have a higher rate of entrepreneurship than do the native born. If we want more entrepreneurship – and we do – then immigration is a great source.

Fourth, it also follows that more immigrants in the workforce mean more consumers.

Richard Vedder, a distinguished professor of economics emeritus at Ohio University and leading thinker on issues relating to economic growth, summed up the economic role of immigration this way: "It turns out that periods of dynamic economic growth and change have roughly coincided with surges in immigration. In part, of course, immigration responds to improved economic conditions. But the evidence strongly suggests that the reverse is also true: Growing immigration has added to the nation's economic vitality and entrepreneurial spirit and has propelled the nation toward higher rates of economic growth." Vedder also made the critical point that when assessing the impact of immigration, one cannot stop at the immigrants themselves: "The children of immigrants are the most productive generation of all, typically with income and wealth exceeding that of the general population."

Focusing on the economics, as opposed to the political rhetoric, it's clear that immigration is another example of American opportunity that benefits the entire nation.

Thank you again for your invitation to be a part of this important hearing today.

About Raymond J. Keating

Raymond J. Keating serves as chief economist for the Small Business & Entrepreneurship Council. Keating is the author of several nonfiction books, including *Free Trade Rocks! 10 Points on International Trade Everyone Should Know* and *Unleashing Small Business Through IP: The Role of Intellectual Property in Driving Entrepreneurship, Innovation and Investment*. Keating also is a novelist and indie publisher, having written fifteen Pastor Stephen Grant thrillers and mysteries. He also is a podcaster, hosting, for example, the *Free Enterprise in Three Minutes Podcast*. Keating was a regular columnist with RealClearMarkets.com, and for more than two decades was a weekly newspaper columnist with *Long Island Business News*, *Newsday*, and the *New York City Tribune*. For a decade, Keating also was an adjunct professor in the MBA program at the Townsend School of Business at Dowling College. His work has appeared in a wide range of additional periodicals, including *The New York Times, The Wall Street Journal, The Washington Post, New York Post, Los Angeles Daily News, The Boston Globe, National Review, The Washington Times, Investor's Business Daily, New York Daily News, Detroit Free Press, Chicago Tribune, Providence Journal Bulletin,* and *Cincinnati Enquirer*.