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The State of American Small Businesses Post-Pandemic: Identifying Headwinds and Crafting Market-Based Solutions

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TOPLINE POINTS

- ★ Although small businesses have made some recovery from the depths of the COVID-19 pandemic, they still face continuing headwinds from unprecedented labor supply shortages and historic inflation with no end in sight. They have also been hit with higher associated borrowing costs, supply chain struggles tax uncertainty, and an administration that has piled on more regulation in its first year than any other president in history.
- ★ All these headwinds have downstream effects on the American worker and must be addressed so they can have faith and security in their employment and continue to grow their careers.
- ★ As set forth herein, implementing policy solutions to curb inflation, promote work and investment, and ensure that business owners and workers keep more of the fruits of their productive activity will strengthen small businesses and our Nation's economic outlook and prosperity for American families.

INTRODUCTION

Small businesses[1] have long been the lifeblood of our Nation's economy and employ roughly half of America's workforce today. Like most Americans, small business owners and employees faced unforeseen circumstances with the COVID-19 pandemic but have proven resilient through these harrowing events. The strength and vitality of America's small businesses are deeply intertwined with the strength of our Nation's economic well-being. Fortunately, due to the prompt and sound policy actions of the Trump Administration, such as the Paycheck Protection Program assisting small businesses to help them retain and rehire employees, economists estimate that as many as 17.7 million Americans were saved from furlough and termination.

The following issue brief assesses some of the existing headwinds that small businesses face and offers policy recommendations to alleviate them. In examining the state of small businesses and the downstream impact on the American worker, many factors may be considered, such as labor availability and quality, revenues, new starts, bankruptcies, regulatory and tax uncertainties, and credit

[1] For this report, we define small businesses as "The Office of Advocacy defines a small business as an independent business having fewer than 500 employees." If it is defined differently, it will be explained in the text.

access. This paper looks at these in the context of the current business climate to provide actionable insights.

LABOR SUPPLY SHORTAGES

America is experiencing an unprecedented labor shortage, a driving force behind the 40-year high inflation ravaging the economy and families' pocketbooks. According to labor market data from the Bureau of Labor Statistics, the economy had more than 10.7 million job openings at the end of September 2022 and only around 6.1 million unemployed workers to fill those positions. As a result, about 1.8 job openings currently exist for every unemployed person. The phenomenon of more jobs being available than unemployed persons seeking one is relatively new, initially beginning in 2018 and continuing until the pandemic, and then resuming in July of 2021, and not previously seen in this century. This unprecedented scenario presents a uniquely challenging situation for small businesses.

These labor supply shortages have been exacerbated by difficulty identifying qualified applicants. This issue could undoubtedly be addressed in part by more targeted training and apprenticeship programs, such as the flexibility of Trump-era initiatives like the Industry-Recognized Apprenticeship Program (IRAP) and the Pledge to American Workers.[2] [3]According to data from payroll solutions provider ADP, while large and medium-sized enterprises continue to grow, employment at firms of fewer than 20 workers has declined so far in 2022. Based on the October survey of small business owners conducted by the National Federation of Independent Business, 90 percent of the small businesses that were trying to hire "reported few or no qualified applicants for the positions they were trying to fill." The Small Business Administration has also cited this concerning trend that developed after the beginning of the COVID-19 pandemic, publicly stating that "[w]hile smaller establishments had higher gross openings before the pandemic, the national labor shortage particularly impacted smaller establishments." The small businesses themselves certainly reflect this apprehension. From August 2020 to March 2022, labor needs cited as a priority has gone from 23–40 percent, according to the U.S. Census Bureau. As discussed herein, this critical issue presents an opportunity for market-based solutions to bring more people into the workforce and demands leadership from Washington to implement policies that foster hiring efficiencies for our businesses, large and small.

SUPPLY CHAIN DISRUPTIONS

Supply chain struggles and the associated business disruptions have put tremendous stress on the economy and the greater small

[2] The Industry-Recognized Apprenticeship Program was created through a 2017 executive order that directs the Secretary of Labor to consider proposing regulations that promote the development of apprenticeship programs by third parties.

[3] The Pledge to the American Worker, created in 2018, was a public-private partnership program that asked companies and trade groups to commit to expanding programs that educate, train, and reskill American workers from high-school age to near retirement. It was discontinued in 2021.

business ecosystem, with 89 percent of all small businesses citing it as impacting their business. (NFIB Survey) Unlike large companies, which typically maintain significant financial reserves, small businesses struggle to seek out new customers while their revenues and savings tick downward.[4] Even if they can somehow gain access to these goods, small businesses do not have the economies of scale of larger companies. As such, they have limited options to keep up with increased pricing—either dip into their limited savings or tap into the credit markets for additional working capital. However, as noted, access to capital can often present challenges for small businesses, and as discussed below, recent inflationary activity has presented even more substantive hurdles for small business borrowers.

INFLATION

Inflation drives up the cost of everything as too many dollars chase too few goods. Recent government actions have significantly contributed to the current inflation plaguing Americans by pumping trillions of dollars into the economy. These circumstances juxtapose a country that needs to fill jobs to produce more output against an artificially suppressed supply of workers from government handouts such as extended unemployment insurance and student loan forgiveness, the latter of which will cost Americans about an additional $400 billion (CBO). With this inflationary climate and the delayed monetary policy of the Federal Reserve, America's small businesses are struggling to hire employees, realizing tighter profit margins, and struggling to access lending capital, placing them at a significant disadvantage to large corporations. While the current administration discusses its actions to stop the current state of inflation, the late conservative economist Milton Friedman previously provided critical advice that is not being followed. Friedman said, "[i]nflation is an old, old disease. We've had thousands of years of experience of it. There is nothing simpler than stopping an inflation—from the technical point of view. The only cure for inflation is to reduce the rate at which total spending is growing." With the current rate of government spending and the development of unchecked liberal programs and handouts, there is no foreseeable relief for American small businesses.

CREDIT DEMAND, AVAILABILITY, AND USAGE

The most pressing credit problem facing American small businesses is skyrocketing interest rates. In November 2022, the Federal Reserve raised the federal funds rate by 75 bps to a target rate of 3.75–4.0 percent, the highest borrowing rate since 2008 and the sixth increase in 2022. With potentially more rate hikes on the horizon, the ongoing interest rate hikes to combat inflation have significantly impacted small business lending and, therefore, their ability to invest in their companies and workforce. With depressed revenues and as access to capital and credit

[4] For example, Walmart addressed its supply chain issues head-on when it began to charter its own cargo ships to bypass congestion at U.S. ports, but small businesses did not enjoy this luxury.

becomes more expensive, many small businesses will likely be forced to close their doors, as data shows that many of these loans are now used for operational support instead of business expansion.[5] [6] An additional access to credit headwind for small businesses is the legacy of the Dodd-Frank Act from the Great Recession of 2008, which "disproportionately reduced the incentives for all banks to make very modest loans...." (NBER)This is one regulatory hurdle for small businesses, but many others remain. While businesses undoubtedly close for traditional market reasons, small businesses must have a level playing field upon which to engage the market. Financial services companies like American Express have provided best practices advice to assist small businesses in navigating the current climate, such as cutting expenses and raising prices judiciously. However, the fact remains that any pragmatic guidance comes down to basic austerity measures, and "prosperity should be our goal, not austerity." [7]

OTHER REGULATORY BURDENS

In its first year, the Biden Administration implemented 69 major regulations, more than any other President in modern history. This amounted to 72,000 pages of additional regulations, agency information, and executive orders. The American Action Forum (AAF) has estimated that these new regulations total an additional $201 billion in regulatory costs and 131 million hours in new yearly paperwork requirements (or 65,000 full-time jobs to complete paperwork). For comparison, another AAF analysis showed that over its entire four years, the Trump Administration only totaled $40.4 billion in regulatory costs. The Trump White House Council of Economic Advisers estimated that this deregulatory strategy embraced by the Trump Administration, where eight regulations were cut for each new one implemented, increased real incomes for U.S. households by $3,100 per year.

An increase in regulation results in more administrative bureaucracy for the end user. In this case, the lean staff of small businesses are forced to utilize personnel to complete forms, hire legal and compliance experts, and take many other actions that have nothing to do with revenue creation. Unlike large companies, many small businesses do not have the staff or the resources to do both. Furthermore, the costs of these regulatory burdens are often passed on to consumers, with data demonstrating that "a 15 percent increase in federal regulation hikes the cost of consumer goods by a full percentage point" (Mercatus). In short, there is a fixed cost nature to regulation. Whether they serve one

[5] Again, among the 11,000 small businesses surveyed, the Small Business Credit Survey found that "revenues remain below pre-pandemic levels for 63 percent of firms, and employment is lower for 43 percent." The Federal Reserve data found that "Forty-eight percent of firms saw a decrease in revenue over the prior 12 months, while 38 percent saw an increase; see Small Business Credit Survey.

[6] A closer look at the Federal Reserve survey data reveals that "[t]he shares of [small business] applicants that sought funds for operating expenses grew from 43 percent in 2019 to 62 percent in 2021, while the share that sought to fund business expansion fell from 56 percent in 2019 to 41 percent in 2021."

[7] Quote from Conservative Member of U.K. Parliament Andrew Ledsom.

million customers or one thousand customers, more regulation can adversely impact small businesses' ability to compete and innovate- all of which is a detriment to the consumer and more considerable economic growth.

TAX UNCERTAINTY

When businesses are already facing hiring challenges, rising costs, supply chain woes, and increased regulatory burdens, the last thing they need is a tax hike. However, that is what they potentially face very soon if the 2017 Tax Cuts and Jobs Act (TCJA) is not made permanent. This law reduced the corporate tax rate from 35–21 percent and made U.S. businesses more globally competitive. Along with increasing investment in domestic plants and fully expensing equipment, companies invested in workers instead of tax bills. TCJA also allowed small businesses to deduct 20 percent of their business income. Any expiration or phasing out of this law would damage all businesses and their hiring ability. Increasing tax certainty and ensuring a low tax burden on hardworking Americans would ease some of the pains America's small businesses face.

IMPACT ON THE AMERICAN WORKER

So, what do all these significant challenges mean for the American worker? The downstream impacts on the American worker are numerous, including limited opportunities to identify and train for these available positions. However, the policies embraced by the current administration will determine whether training opportunities are available and whether these job openings will even exist in the future. Suppose, for example, the supply chain issues remain, the inflation scenario worsens, and the tax uncertainty lingers. In that case, businesses will continue to see operational credit challenges, impacting their hiring ability. For example, private sector support for tech-enabled solutions and a deregulatory framework that permits mobility in occupational licensing can undoubtedly be impactful in advancing career opportunities for the American worker. While the current administration may give lip service to small businesses, their actions speak louder than words. Massive increases in spending, rampant inflation, and increased regulation are presenting seemingly insurmountable challenges to our country's small businesses and workforce.

Moreover, while folks will still look for full-time opportunities, including direct hiring and apprenticeship programs- many will also engage in the gig economy as something of a "side hustle." The evidence will determine whether this becomes something of the new normal generationally. However, the current administration's policies have made this a less viable pathway for many. Career trajectory should always be a choice for the American worker, but with high taxes, high regulation, and high inflation, the options for many Americans have become much more limited to putting food on the table.

POLICY RECOMMENDATIONS

Policymakers must undertake a specific list of policy prescriptions to aid our small businesses. Our labor shortages and sluggish supply chain go hand in hand. The fewer workers we have, the slower our supply chain will function. One way to fix this is to increase targeted training and apprenticeship programs, especially in the field of manufacturing. Public-private partnerships, like the previously mentioned IRAP and the Pledge to American Workers, will incentivize business owners to train qualified workers to ease the burdens on the American supply chain.

American lawmakers must stop their rampant spending, especially in government programs that disincentivize work among able-bodied adults, to slow down inflation and ease credit access for small businesses. Aside from the increased costs of doing business caused by inflation, the Federal Reserve's attempts to cool inflation by increasing interest rates have disproportionately harmed American small businesses. The best way to prevent further inflation would be for the government to cut spending drastically. To ease the inflationary burdens on small businesses, Congress should reauthorize the 2017 TCJA, ensuring tax certainty and allowing businesses to keep more profits.

Finally, regulatory burdens remain a lingering thorn in the sides of businesses. The tens of thousands of new pages of regulations mean additional time and costs for small businesses to ensure compliance. These marginal hours and dollars are more significant to smaller businesses than larger ones and are a further competitive disadvantage from which they suffer.

CONCLUSION

The Nation's current economic climate is difficult for small businesses and the American worker. While the costs of goods rise and inflation soars, coupled with the deleterious impacts of supply chain disruptions and tax uncertainty, small businesses must plan to navigate turbulent economic waters that seem to have no end. While hiring remains a challenge for them, it is not easy to plan accordingly, which presents challenges for those seeking employment longevity. Many of these issues can be addressed market-based when supported by appropriate fiscal policy, sound regulatory judgment, and concentrated avenues that identify and train workers for available positions in real-time. However, these require thoughtful, steady, and principled national leadership, which, unfortunately for all of us, is currently lacking.

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