Testimony of
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On behalf of the small-business members of the Pennsylvania chapter of the National Federation of Independent Business, I want to thank you for inviting me to talk with you today about Pennsylvania's economic development policies and programs.

NFIB is a melting pot of commercial enterprises, manufacturers, family farmers, neighborhood retailers and service companies. NFIB members typically employ five workers and report gross sales of around $400,000 per year. In the aggregate, these small businesses are a potent economic force – employing over 210,000 and earning over $19 billion (gross) annually.

Almost half of our members make their living in the retail and service sectors. Thirty percent of our members are in construction, manufacturing and mining. Sixteen percent of our members are in the wholesale trade and agriculture, forestry and fishing industries. About eight percent of our members work in the financial services, transportation and utilities industries.

In Pennsylvania, as in the nation as a whole, small firms lead the way in employment and job creation. Nearly 98 percent of all businesses in Pennsylvania employ fewer than 100 workers and small businesses create almost 80 percent of the new jobs in the Commonwealth.

In addition to providing a livelihood for their own families, Pennsylvania's small-business owners provide almost half of all wage-and-salary jobs in the state's private sector.

Very few NFIB members report they have taken advantage of economic development programs offered by the Commonwealth. The reality is that most of these programs are not designed to meet the needs of small business.

The advocacy office in the US Small Business Administration reported last February that the most important thing state governments can do to influence economic growth is to increase the number of small business establishments. The report's authors concluded the most fruitful policy option for states seeking economic growth is to establish and maintain a fertile environment for new business formation.

In its annual report, the advocacy office document a phenomenon it termed "economic gardening." The report suggested states should focus on grooming new and existing entrepreneurs instead of chasing larger companies - a practice know as "economic hunting." The SBA reported that luring existing large businesses into town can be expensive and unrealistic. Instead, economic resources are better spent on existing and nascent businesses located in one's own community.

Pennsylvania's existing economic development strategy runs counter to these policies. But the Commonwealth is not alone. State governments across the nation offer myriad inducements to large corporations, including tax abatement, land acquisition, construction subsidies, training subsidies, and outright cash grants. Nationally, relocation incentives total about $50 billion a year.

When the Korean car maker Kia decided to build a $1.2 billion plant in West Point, Georgia, the state offered a $420 million incentive package that included free land, tax-funded employee training, and a new $30 million Interstate interchange. Altogether, the subsidies amounted to roughly $168,000 for each of the 2,500 jobs at the plant.

While Georgia's Gov. Sonny Perdue believed the incentives were the reason Kia located to the state, economists said the reason Kia picked the state was obvious: neighboring Alabama had a trained force of autoworkers, so Kia located on the Georgia-Alabama border. In other words, Georgia taxpayers are paying Kia hundreds of millions of dollars to hire Alabama workers.

More often than not, these subsidies and programs give the appearance of creating jobs. But there is little evidence to suggest a connection between subsidies and job creation.

The Mackinac Center studied several Michigan state "economic development" projects from 1998 to 2002. Seven companies received a total of $120 million in grants from the Michigan Economic Development Commission on the promise to create 775 jobs, a goal that was later reduced to 458. When the job creation project was complete, the companies claimed they had exceeded the revised goal by 177 jobs. But when the Michigan auditor general's office examined the companies' actual reports, it turned out the enterprises had actually lost 222 local jobs.

Advocates for government subsidies don't just point to the jobs the businesses they entice will have to create. They argue that there is an economic "multiplier" effect, by which spending at a factory or entertainment venue indirectly generates spending on other goods and services. Many economists say that never happens.

Here in Pennsylvania, the administration touts almost $4 billion in borrowing to entice large corporations to come to Pennsylvania. These funds have been used for loans and guarantees to venture capital partnerships. Another economic development tool used by state government to attract large companies is tax-free zones.

Unfortunately, these policies and programs force the state to pick economic winners and losers. The venture programs for example take hard-earned tax dollars from tried-and-true existing Pennsylvania companies and use them to finance projects and take on risks the private sector isn't willing to assume.

Furthermore, the tax-free zones benefit mostly larger firms at the expense of small firms that have existed in the local community for years. These programs essentially penalize successful businesses by virtue of the side of the street they are located and the number of years they have done business in the same location.

The most recent example of this type of "economic handicapping" can be found in the governor's proposed energy independence strategy.

Under the plan, the administration seeks to borrow nearly $1billion primarily to help large multinational corporations pay for their research and development.

Supporters of these tax-and-spending energy mandates tout them as positive for Pennsylvania's economy. Unfortunately, the jobs attracted to the Commonwealth could come at the expense of thousands of existing small-business jobs in Pennsylvania.

Energy is a major cost in a substantial share of small businesses. One in 10 small-business owners report that energy is their single greatest cost, greater than wages and salaries, materials and supplies, etc. Another 25 percent claim energy is one of the two or three largest business costs they have.

There is little doubt that energy costs will rise over time. However, what sets Pennsylvania apart is that these policy changes -- taxing small Pennsylvania businesses to pay for big-business research and development -- will make it harder for Pennsylvania-based firms to compete with businesses located in other states and countries.

Increasing taxes on Pennsylvania-based companies will make it harder for small in-state companies, especially small manufacturers, to be competitive in the global market place and attract revenues from out of state. This means less not more total revenue is being generated.

The proposed energy tax will be assessed without regard to small companies' profitability levels. For some manufacturers, these new taxes can accelerate or even lead to the demise of companies which are trying to rebound from a difficult financial situation.

Small businesses would much rather use the funds to invest in energy-efficient equipment to help them lower their energy bills rather than funding multi-national corporations.

In closing, I think it is important to point out that history has demonstrated that governments have not been particularly successful in making capital allocation decisions. If the political command economy really worked, the Soviet Union would have won the Cold War. Subsidies of capital costs cannot compensate for the Commonwealth's hostile tax environment.

The inability of state government to foster an environment that encourages entrepreneurs to create jobs in Pennsylvania has produced the exodus of the best and brightest young people to states with more favorable climates for businesses.

NFIB's members believe a more effective economic development strategy would be to put an end to taxpayer-funded zones and other subsidy programs that support a select few businesses.

Instead, reduce Pennsylvania's tax burden on job creators across the board and allow entrepreneurs to make their own capital allocation decisions.

Thank you for the opportunity to appear before you today. I am happy to answer any questions that you may have.

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