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“The Small Business Workforce Challenge: Causes, Impacts and Solutions”

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*I am grateful to my former colleague Dr. Marian Negoita for his contributions to the research findings I will share today.

Chairman Cardin, Ranking Member Paul, and Members of the Committee, I am honored to testify before you this afternoon about the causes, impacts, and solutions to the workforce challenges facing small businesses and entrepreneurs. My name is Annelies Goger. I am a Fellow at Brookings Metro at the Brookings Institution and an economic geographer specializing in U.S. workforce policy, inclusive economic development, and global supply chains.

I appreciate you taking up this topic, because it has personal significance for me. My father owns a small business, a lightning rod installation company with two employees. He doesn't have a college degree and he has always been self-taught.

Finding and managing talent has always been a challenge for him, and it has been difficult for him to get the support he needs to learn how to manage his team better. For example, one day last summer one of his employees announced on a Friday that he was taking the next two weeks off for vacation. I asked my father if he had a paid time off policy, so that he could hold the employee accountable for failing to give sufficient notice. He didn't. So I searched around on the Small Business Development Center (SBDC) website to see if they had a free template that he could use that was also compliant with state law. They didn't.

To understand why, we need a brief history lesson. Throughout the history of capitalism, there has been a back-and-forth dynamic between protectionism and liberalism – well articulated in Karl Polanyi's seminal book *The Great Transformation*. If we reflect back on the 20th century lessons from this dynamic, I hope we can agree on two observations relevant to small businesses: (1) too much focus on protectionism is bad because over-regulated markets fail to innovate and adapt, and it can prop up businesses that generally are not viable in the long run or serving in the

public interest. (2) too much focus on liberalization is also bad, because under-protection can cause massive pain in times of economic shock (such as a pandemic) and can lead to monopolistic or oligopolistic markets and supply chains that ultimately also constrain innovation and increase consumer prices. Since the 1980s, the pendulum has swung towards neoliberalism – in other words, a non-interventionist approach of lean government. You can think of this as the laissez-faire, Darwinian approach: the best businesses will survive and that the growing concentration of wealth at the top will ultimately trickle down and “lift all boats.”

Unfortunately, instead of a trickle down, we are now seeing rising income and wealth inequality and growing concentration in many supply chains, which tends to squeeze the profit margins of small business like my father’s. What this means for the level of support available to small business owners, whether through SBDCs, extension programs, or the Workforce Innovation and Opportunity Act job centers, is that the resources available are quite limited.

It’s in this context of limited small business support that COVID-19 struck. Suddenly the darwinian scenario morphed into something more like a *Squid Games* scenario from the perspective of many small businesses. We all saw the carnage. It is in temporary shocks like this that you really see the need for support and protections. Congress responded with high levels of temporary relief such as PPP for small businesses that – evidence suggests – appear to have moderated the worst of the economic impacts of COVID-19 not only on small businesses but overall in terms of keeping spending high and spurring a comparatively rapid economic recovery.¹

Business starts increased 20.6% from 2020 to 2021, especially in e-commerce, professional services, administrative support, construction, and warehousing/logistics.² Moreover, the share of Black-owned and women-owned micro-businesses increased in the pandemic.³ The labor force participation rate declined to a low of 60.2% in April 2020,⁴ but labor force participation has risen back up to 62.3% by May 2022. It is still 1.1 percentage points lower than pre-pandemic labor force participation rates.⁵

The question now is how to support small businesses cope with the current pain points – one of the largest is a workforce challenge.

The pain is real. The April 2022 JOLTS survey from the Bureau of Labor Statistics found that small businesses with 10 to 49 employees were hit the hardest by hiring challenges and employee churn.⁶ The survey found that these small businesses had the highest number of job openings, highest number of quits in a single month, and the lowest number of involuntary layoffs in the history of the survey since 2000. Small businesses typically lack the resources to offer competitive pay, benefits, and flexibility compared to larger companies.

¹ Haltiwanger, J. June 2021. “Entrepreneurship During the COVID-19 Pandemic: Evidence from the Business Formation Statistics.” Accessed June 6, 2022 from: <https://www.nber.org/system/files/chapters/c14575/c14575.pdf>.

² Betterton, K. February 15, 2022. “Top 5 Types of Businesses Started During the Pandemic.” U.S. Chamber of Commerce. Accessed June 6, 2022 from: <https://www.uschamber.com/co/start/strategy/top-businesses-started-during-pandemic>.

³ Hartman, J. and J. Parilla. January 4, 2022. “Microbusinesses flourished during the pandemic. Now we must tap into their full potential.” The Brookings Institution. Accessed June 6, 2022 from: <https://www.brookings.edu/blog/the-avenue/2022/01/04/microbusinesses-flourished-during-the-pandemic-now-we-must-tap-into-their-full-potential/>.

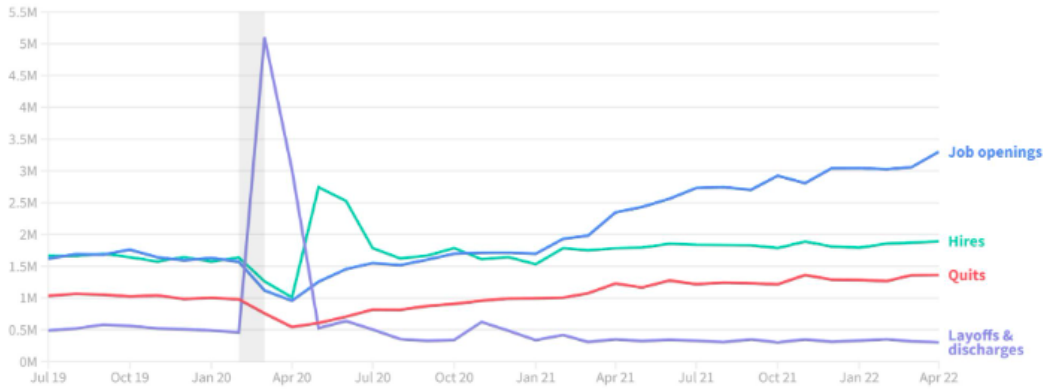
⁴ Congressional Research Service, August 20, 2021. “Unemployment Rates During the COVID-19 Pandemic.” Accessed June 6, 2022 from: <https://crsreports.congress.gov/product/pdf/R/R46554>.

⁵ U.S. Bureau of Labor Statistics, June 3, 2022. “Employment Situation Summary – May 2022.” Accessed June 6, 2022 from: <https://www.bls.gov/news.release/empsit.nr0.htm>.

⁶ U.S. Bureau of Labor Statistics. June 1, 2022. Job Openings and Labor Turnover Survey. Accessed June 6, 2022 from: <https://www.bls.gov/jlt/>.

April was a record-breaking month for small businesses

Levels of job openings, hires, quits, and layoffs and discharges for establishments with 10 to 49 employees, seasonally adjusted



Source: U.S. Bureau of Labor Statistics, Job Openings and Labor Turnover Survey (JOLTS), released June 2022



So, what's going on here? What are the causes? I wish there were a simple explanation, but we have a complex, perfect storm of factors, including some factors that were directly related to the pandemic and others that are longer-term trends.

Pandemic-related factors

- **Lower Immigration:** Had we not had COVID-19 restrictions on immigration in the U.S., economists estimate that we would have had roughly 2 million more working age immigrants in the U.S., including 950,000 college-educated immigrant workers.⁷ Many of the industries struggling the most to fill job openings such as health care, hospitality, and construction, have historically had a disproportionate share of immigrants in their workforce.
- **Higher death rates:** Over 250,000 Americans of prime working age, 18 to 64, died due to COVID-19.⁸
- **Lack of childcare:** Parents, and predominantly women, continue to contend with COVID-19 exposures in schools that shut down classrooms and subsequently leave parents with a lack of reliable and affordable childcare. Women also were disproportionately impacted by pandemic-related job losses due to their concentration in jobs that must be performed in person. This may be contributing to the ongoing churn and elevated quit rates in the labor market.⁹
- **Friction in reallocation:** When lockdowns began, more than 22 million Americans lost their jobs. Once job loss occurs, especially with structural shifts in demand away from sectors such as hospitality and towards sectors such as e-commerce and warehousing, it can take a long time for employers and workers to match with each other. In addition, the health crisis deterred many workers in frontline jobs, especially those at high risk of severe cases, from returning to frontline work.

Long-term trends

- **Demographic shifts:** The pandemic accelerated a wave of retirements that has been looming among the baby boom generation. Economists at the St. Louis Fed estimated 2.4

⁷ Peri, G. and R. Zaiour, January 11, 2022. "Labor Shortages and the Immigration Shortfall." Econofact. Accessed June 6, 2022 from: <https://econofact.org/labor-shortages-and-the-immigration-shortfall>.

⁸ Center for Disease Control, June 2, 2022. "Weekly Updates by Select Demographic and Geographic Characteristics." Accessed June 6, 2022 from: https://www.cdc.gov/nchs/nvss/vsrr/covid_weekly/index.htm#SexAndAge.

⁹ Stevenson, B. 2021. "Women, work, and families: Recovering from the pandemic-induced recession." The Brookings Institution. Accessed June 6, 2022 from: <https://www.brookings.edu/research/women-work-and-families-recovering-from-the-pandemic-induced-recession/>.

million “excess” retirements due to the pandemic.¹⁰ There are fewer young workers to replace retired workers due to lower fertility rates, declining labor force participation, and lower immigration.¹¹

- **Underinvestment and uneven investment in talent:** The younger generations to replace baby boomers are smaller and more racially and ethnically diverse, by comparison. Since the 1980s, we have decreased funding for education and training for youth and workers who are not on a path to a college degree. The U.S. spends roughly 1/5th the average spending among OECD countries on “active labor market programs” to support people seeking a job or training opportunity.¹² Employers also tend to under-invest in training their existing workers, especially frontline workers.¹³ Moreover, Harvard researchers suggest that the U.S. could quadruple innovation if we invested more equally in talent.¹⁴
- **Discrimination and stigma:** Black and Latino or Hispanic candidates, formerly incarcerated individuals, older workers, veterans, and workers with disabilities historically encounter disproportionately high levels of discrimination in the labor market, so they have disproportionately high rates of unemployment and tend to take longer to get a job. The latest data from the Bureau of Labor Statistics suggest that there remain 1.4 million long-term unemployed workers.¹⁵
- **Untapped talent:** many employers (including the federal government) over-rely on college degrees as a screening requirement for jobs that do not truly require a degree artificially limits the pool of talent.
- **Digitalization of work:** As the labor pool declines, employers are also confronting the rapid pace of technological change in every industry and occupation.¹⁶ This shift to automated production, the use of digital platforms and cloud-based services, and artificial intelligence means that employers and workers both must adapt more often to update their work practices and skills to stay competitive and innovative. A college-for-all, one-and-done model of learning is inconsistent with the growing need for lifelong learning and talent investment in the labor market.¹⁷ It is unclear how small businesses will be able to keep up with work trends in the digital age under the current policy environment, which could dampen innovation, regional vitality, and the wealth distribution.

Some have argued that expansions to Unemployment Insurance (UI) eligibility and benefit amounts caused the labor shortage. Evidence from the most severe stages of the pandemic-related recession suggest that UI expansions may have had a small effect on employment, but they were not the key factor.¹⁸ More recent evidence since the summer of 2021 suggest that the states that

¹⁰ Federal Reserve Bank of St. Louis, December 28, 2021. ““Excess” Retirements during the COVID-19 Pandemic.” On The Economy Blog. Accessed June 6, 2022 from: <https://www.stlouisfed.org/on-the-economy/2021/december/excess-retirements-covid-19-pandemic>.

¹¹ Toossi, M. 2016. “A Look at the Future of the U.S. Labor Force to 2060.” U.S. Bureau of Labor Statistics. Accessed June 6, 2022 from: <https://www.bls.gov/spotlight/2016/a-look-at-the-future-of-the-us-labor-force-to-2060/home.htm>.

¹² Goger, A. July 23, 2020. “Turning COVID-19’s mass layoffs into opportunities for quality jobs.” The Brookings Institution. Accessed June 6, 2022 from: <https://www.brookings.edu/research/turning-covid-19s-mass-layoffs-into-opportunities-for-quality-jobs/>.

¹³ Negoita, M. and A. Goger, 2020, July 2020. “State-Level Policies to Incentivize Workplace Learning: Impacts of California’s Incumbent Worker Training Program.” Social Policy Research Associates. Accessed June 6, 2022 from: https://www.brookings.edu/wp-content/uploads/2020/07/Neigoita_Goger_final.pdf.

¹⁴ Bell, A., Chetty, R., Jaravel, X., Petkova, N., & Van Reenen, J. 2019. “Who becomes an inventor in America? The importance of exposure to innovation.” *The Quarterly Journal of Economics*, 134(2), 647-713.

¹⁵ U.S. Bureau of Labor Statistics, June 3, 2022. “Employment Situation Summary – May 2022.” Accessed June 6, 2022 from: <https://www.bls.gov/news.release/empsit.nr0.htm>.

¹⁶ Autor, D. 2022. “The Labor Market Impacts of Technological Change: From Unbridled Enthusiasm to Qualified Optimism to Vast Uncertainty.” No. w30074. National Bureau of Economic Research.

¹⁷ Goger, A. December 9, 2020. “Desegregating work and learning through ‘earn-and-learn’ models.” The Brookings Institution. Accessed June 6, 2022 from: <https://www.brookings.edu/research/desegregating-work-and-learning/>.

¹⁸ Ganong, P., F. Greig, P. Noel, D. M. Sullivan, and J. Vavra, July 29, 2021. “Micro and Macro Disincentive Effects of Expanded Unemployment Benefits.” Accessed June 6, 2022 from: <https://www.jpmmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/institute/pdf/when-unemployment-insurance-benefits-are-rolled-back-paper.pdf>.

ended these expanded benefits earlier had a modest improvement in employment and labor force participation compared to states that did not.¹⁹ However, all states ended the expanded benefits on Labor Day in 2021, therefore there is little reason to believe that they are having a major effect on employment and labor force participation today.

Solutions

In developing solutions to the talent challenges that small businesses are experiencing, it is important to think about short- and medium-term solutions that address the stress caused by the ongoing out-of-whack pandemic economy and solutions that address broader trends that are likely to make talent more expensive to attract, manage, and retain in the long run.

It is also important to consider different policy responses for very small businesses (micro-enterprises) of less than 20 employees compared to medium-sized businesses with 21 employees or more. I will share some findings from some of my evaluation research to stress the importance of this.

My study with former colleague Marian Negoita examined California's Employment Training Panel program, which reimburses employers for training based on a pay-for-performance approach. We found that training reimbursements had the greatest and most significant effect on medium-sized businesses with 19 to 100 employees in terms of job creation and sales revenue.²⁰

- Sweet spot of investment for job creation and economic growth
- California Employment Training Panel – tax collected alongside UI is redistributed to employers to reimburse them to train
- Propensity score matching to compare similar companies that did and did not receive the reimbursement
- We obtained negative impact estimates for the smallest companies (1-18 employees) in terms of employment and sales, although the finding on the impact on sales was not statistically significant. By contrast, companies in the next size bracket (19-50 employees) appeared to experience large and positive impacts on both outcomes, with each hovering around 40 percent. The positive impacts persisted for the next larger size category (51-100 employees), although they decreased in size compared to the previous bracket. Finally, the impacts for the largest category were small and not statistically significant.

Short- and medium-term responses

- Support policies to expand legal immigration and address delays in processing of work visas, potentially identifying industries of highest priority with the most openings
- Create mechanisms for small businesses to pool resources, e.g., by sector or trade association, especially for micro-enterprises, for:
 - Community training centers and small business incubators
 - Benefits pools – e.g., health insurance, liability insurance

Ganong, P., F. Greig, M. Liebeskind, P. Noel, D. Sullivan, and J. Vavra. February 2021. "Spending and Job Search Impacts of Expanded Unemployment Benefits: Evidence from Administrative Micro Data." University of Chicago, Becker Friedman Institute for Economics Working Paper 2021-19. Accessed June 6, 2022 from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3784008.

Dube, A. February 2021. "Aggregate Employment Effects of Unemployment Benefits During Deep Downturns: Evidence from the Expiration of the Federal Pandemic Unemployment Compensation." No. w28470. National Bureau of Economic Research. Accessed June 6, 2022 from: <https://www.nber.org/papers/w28470>.

¹⁹ Holzer, H. J., Hubbard, R. G., & Strain, M. R. 2021. "Did Pandemic Unemployment Benefits Reduce Employment? Evidence from Early State-Level Expirations in June 2021." No. w29575. National Bureau of Economic Research. Accessed June 6, 2022 from: https://www.nber.org/system/files/working_papers/w29575/w29575.pdf.

²⁰ Negoita, M. and A. Goger, 2020, July 2020. "State-Level Policies to Incentivize Workplace Learning: Impacts of California's Incumbent Worker Training Program." Social Policy Research Associates. Accessed June 6, 2022 from: https://www.brookings.edu/wp-content/uploads/2020/07/Neigoita_Goger_final.pdf.

- Technology adoption and implementation (including training) – Accounting software, CRM software, digital literacy
- Hiring, onboarding, human resources management, accounting

Lasting solutions

- To adapt polity to the modern economy, consider expanding the Manufacturing Extension Partnership (MEP) concept beyond manufacturing, such as services.
 - Educate small business employers about how they can adjust their hiring and management practices through practices such as skills-based hiring and revisiting job descriptions, offering career ladders and advancement opportunities, and offering mentorship opportunities.
 - Provide support to small business owners to understand how to reach younger talent effectively, such as through social media, and how to cater talent outreach to populations that continue to be on the sidelines, such as people with a conviction record, older workers, the long-term unemployed, and youth.
 - Educate small business owners about the business case for diversity and inclusion. A study by the Boston Consulting Group found a strong and statistically significant correlation between the diversity of management teams and overall innovation. Companies with above-average diversity reported innovation revenue that was 19 percentage points higher than that of companies with below-average leadership diversity.²¹
 - Provide support to business owners to understand how high turnover impacts labor costs, and promising practices to reduce turnover. Help business owners understand costs *and* benefits of investments in talent, as well as how to measure their return on investment for talent investment.²²
- Consider funding low-interest financing for small businesses, especially in regions and communities that were disproportionately impacted by the pandemic. This could help revitalize commercial districts and ensure that more capital recirculates in the community through local ownership.
- Make apprenticeships and other earn-and-learn opportunities easier and cheaper for small and medium sized businesses to sponsor
 - Registration process is onerous and outdated, training is cost prohibitive to design deliver (without partnerships with community colleges and other education partners)
 - Public investment is needed for upfront, seed funding for businesses to get started in apprenticeship, including funding for outreach, to have managers and supervisors trained on their role, to invest in learning management infrastructure, and to develop of shared competency frameworks with other small businesses and educators/training providers for the occupations in highest demand
 - Longer term model self-sustaining for apprenticable occupations
- Revisit our approach to layoffs and rapid response: The WARN Act system was designed for large scale manufacturing layoffs. It doesn't capture concentrated layoffs of small

²¹ Lorenzo, R., N. Voigt, M. Tsusaka, M. Krentz, and K. Abouzahr. January 23, 2018. "How Diverse Leadership Teams Boost Innovation." Boston Consulting Group. Accessed June 6, 2022 from: <https://www.bcg.com/en-us/publications/2018/how-diverse-leadership-teams-boost-innovation>.

²² A. Goger, C. Sinclair, and A. Dick. March 1, 2021. "An apprenticeship FAQ: What employers need to know about talent development." The Brookings Institution. Accessed June 6, 2022 from: <https://www.brookings.edu/research/an-apprenticeship-faq-what-employers-need-to-know-about-talent-development/>.

firms in one place, nor is it particularly geared towards the needs of service sector small businesses.

To close, I want to speak to the misperception that all one needs to do in the U.S. to succeed is work hard. I can honestly say that I have never met anyone in all my life who works harder than my father has. He works at least 6 days a week, sometimes 7. He is up at 6am to get the team ready to leave by 7 to beat the traffic, and he often stays up past midnight entering data or processing invoices.

But despite all this hard work, the American Dream still hasn't quite panned out. For most of his adult life he did not have health insurance and given that he climbs on roofs all day I realize now how truly lucky we were. He is not perfect, but he would have benefited tremendously from more technical assistance and especially support with human resource management and learning how to use some basic business technologies better. As he is approaching his 70th birthday this fall, he has confided in me that he does not believe he will ever be able to fully retire. I know that he is not alone.

In this era of continued uncertainty, I urge you to implement creative solutions to create and sustain a more inclusive, accessible, viable small business ecosystem in the U.S. because investing in our own diverse talent and entrepreneurs is how we will compete as a country in the digital age. It will be good for business, good for left behind regions, good for communities that were hard hit by the pandemic, and good for majority Black and Latino or Hispanic communities that have historically had less access to generational wealth. Taken together, unleashing the potential in our existing, untapped entrepreneurs and talent is not charity, it is a path to shared prosperity. Indeed, creating a more level playing field of opportunities for talent and small business owners is how we can start to find our way back to the American Dream. Thank you.