Testimony

Submitted on behalf of the
Pennsylvania Chamber of Business and Industry

Public Hearing on Pennsylvania's Business Climate

Before the:
Pennsylvania House Majority Policy Committee

Presented by:

Alex Halper
Director, Government Affairs

Philadelphia, PA
June 4, 2015

417 Walnut Street
Harrisburg, PA 17101-1902
717.720.5471 phone
http://www.pachamber.org

Chairman Benninghoff and members of the Committee, my name is Alex Halper and I am Director of Government Affairs for the Pennsylvania Chamber of Business and Industry. The PA Chamber is the largest, broad-based business advocacy association in Pennsylvania. We represent employers of all sizes, crossing all industry sectors throughout the Commonwealth. Thank you for the opportunity to testify today on Pennsylvania's business climate.

Accurately gauging Pennsylvania's business climate is challenging given the diversity and constantly evolving nature of our state's economy. However, the PA Chamber does attempt to capture the mood of employers in Pennsylvania by surveying businesses, including PA Chambers members and non-members, every year and asking questions related to their businesses, views on the economy in general and matters of public policy. Some sections of the survey change every year; others remain constant and therefore allow us to observe trends and make comparisons.

Our most recent survey was conducted in Sept. 2014. A series of questions were asked to 652 Pennsylvania employers from all over the Commonwealth. The majority of respondents were small businesses, nearly three quarters had fewer than 20 employees, and the most common industries were services, retail and manufacturing.

In general, survey participants last year reported relatively robust sales growth and record levels of optimism. Despite these encouraging indicators, it is clear that employer optimism remains cautious as many continue to hold back on hiring and investments. The following are some additional highlights from the survey that I believe are pertinent to this hearing:

- A combined 57 percent of employers rated the overall business climate in Pennsylvania as either "excellent" or "good", which marks the first time a majority of employers rate Pennsylvania's overall business climate as better than average.
- 39 percent reported increases in sales during the last 12 months, up from 35 percent the previous year – the highest percentage increase in more than five years. Even more promising, 45 percent said they expect sales to increase in the next 12 months, the highest projection level in nearly ten years.
- 22 percent of employers say they hired more workers in the last 12 months; 62 percent experienced no changes. 23 percent said they expect to hire more in the next 12 months. This is the highest we have seen in more than five years but still far below pre-recession levels when new hiring peaked at 41 percent in 2006.
- 20 percent report making major investments in equipment or machinery during the last 12 months, a small drop from the past few years. 67 percent expect no improvements or investments of any kind this year, which we believe shows

heightened reluctance to commit to any new spending or business investments for the immediate future.

- Only 15 percent of employers say they would leave Pennsylvania if they could, which is the lowest in ten years.
- We ask employers to name the issue that most seriously impacts their ability to be competitive, and the most popular responses are general concerns about the economy, taxes and health care costs.

We strongly believe that constructive public policy enacted over the past few years to improve Pennsylvania's business climate have helped spur employers' stronger performances and renewed sense of optimism. Our members were encouraged and grateful to finally see action on numerous important legislative initiatives including lawsuit abuse legislation, putting our unemployment compensation system on a path to solvency and sustainability; bills related to energy policy, transportation, workers' compensation, among many others. On the tax policy front, a numbers of policy changes were implemented, which improved Pennsylvania's ability to better compete with other states, including: increasing the cap on Net Operating Loss deductions; changing the Corporate Net Income tax apportionment formula to 100 percent sales; improving the tax appeals system; eliminating the inheritance tax for small family businesses and continuing the phase-down of the Capital Stock and Franchise tax.

Certainly tremendous progress has been made but these improvements to our business climate have not occurred in a vacuum. Other states have pursued agendas to strengthen their own economies and attract businesses. Unfortunately, many key legislative accomplishments simply address problems or put Pennsylvania on par with the rest of the country. Accordingly, we believe work during this current session should strive to continue the momentum you have generated. As I noted earlier in my testimony, while Pennsylvania employers appear increasingly optimistic, their optimism remains cautious and tempered. In addition to general uneasiness with the national economy, there is clearly much concern among employers that momentum on productive public policy will not only slow down but reverse course.

It seemed this concern was well-founded based on elements of the Administration's proposed budget and other policies that are not in the best interest of employers.

The budget proposal calls for significant increases to the Personal Income Tax rate and the Sales and Use Tax rate, as well as applying the new higher sales tax to numerous additional good and services. Under the plan, a portion of additional revenue coming in to state coffers would eventually be redistributed to reduce school district property taxes, primarily for residential property though the homestead exemption. Many employers would experience a significant tax increase under this taxing scheme, which would also bring uncertainty to public schools by substituting a relatively predictable revenue stream for more volatile taxes that tend to fluctuate with the economy. Furthermore, this proposal provides no additional limits on the extent to which school property taxes can continue to increase – meaning many Pennsylvanians could ultimately be subject to steadily increasing property taxes while still paying the new higher and more expansive income and sales taxes.

We recognize that rising school property taxes are a genuine concern in some areas of the Commonwealth and continue to believe that focusing on those cost-drivers that precipitate higher property taxes first and foremost, most notably public pensions, would be the most effective and sustainable approach to addressing this issue.

The increasing costs and unfunded accrued liability associated with public pensions represents the greatest threat to Pennsylvania's long-term fiscal stability and its impact will be more acute in the years ahead unless substantial reform is enacted. Taxpayers are impacted, as rising costs have precipitated and will continue to require considerable additional revenue and higher taxes. Schools are impacted, as a growing portion of school district budgets must be allocated to fund the local share of pension obligations, pulling scarce resources away from classrooms and students. The Commonwealth itself is impacted, as Pennsylvania's credit has been downgraded by rating agencies, which cited state pensions as a significant factor; and lower bond ratings mean higher costs to borrow money. And finally, current and future public school teachers and state employees are impacted, as confidence in the retirement system on which they are depending is eroded.

The PA Chamber supports Senate bill 1, which we believe would help put the state pension systems on a path to stability and sustainability. In particular, the PA Chamber supports transitioning new employees to a defined-contribution pension plan. The workplace has evolved tremendously over the years, including worker demographics and the tendency for modern employees to frequently change jobs and careers during their working life. Much of the private sector has acknowledged these changes by adopting retirement plans that reflect this new reality – plans that are more portable and provide more discretion for the employee to make decisions concerning savings and retirement age. S.B. 1 represents a long overdue acknowledgment of this reality in the public sector and we urge the House to take up this bill.

With respect to corporate tax policy, we applaud Governor Wolf's proposal to lower the Corporate Net Income tax rate and agreed with him when he described our current rate of 9.99 percent as "obscene." However, we oppose the proposal to adopt mandatory unitary combined reporting, a fundamentally different system for determining a corporation's tax liability that is associated with more complexity, increased litigation, more uncertainty and increased costs of doing business. This concept is touted by advocates as a "loophole-closer" but it is important to recognize that the Department of Revenue current has authority to address any transactions designed solely to avoid taxes and this General Assembly in 2013 gave the Department additional tools to disallow inter-company transactions through expense addback provisions. We also oppose lowering the cap on Net Operating Loss deduction carryforwards, which would roll back important recently enacted changes.

Further with respect to tax policy, we strongly oppose the Administration's proposal to enact a higher tax on natural gas drilling in Pennsylvania. The Administration has estimated its proposed five percent severance tax plus a fee of 4.7 cents/mcf, or thousand cubic feet, would bring in $1 billion and it is attempting to achieve that goal by setting an artificial floor of $2.97/mcf for gas to determine the market price against which a severance tax is assessed. However, due to a combination of prolific gas production and a lack of infrastructure to carry it to market, drillers are being paid very low prices for natural gas production. In some regional hubs, gas is selling for less than $1/mcf. By setting an artificial price floor, the governor's proposal ignores the price signals of the free market, and, in doing so, would establish a severance tax that, depending on the operator, could be an effective rate of 20 percent or more, certainly among the highest tax rates in the nation.

No other state taxes natural gas this way and there is much concern within the industry and many other employers benefitting directly or indirectly from this the economic boon the natural gas industry has created. In fact, at a recent joint Senate Finance Committee and Environmental Resources and Energy Committee hearing, the Independent Fiscal Office confirmed that the effective rate of the governor's severance tax proposal would be the highest in the nation. This plan will seriously harm Pennsylvania's competitive edge in the global energy market and drive jobs and economic opportunity out of the state. The reality is that natural gas drillers are already taxed at a competitive rate through an impact tax passed in 2012. This industry has helped to jump-start the Commonwealth's economy in the aftermath of the recession, creating hundreds of thousands of jobs and turning the state into a leading, world-class energy hub. Enacting this additional, punitive tax will undo the progress and growth we've seen over the past several years.

Our members and employers throughout the Commonwealth have expressed concern with numerous other policies including raising entry-level wages through a minimum wage increase or imposing mandates related to leave policies. This latter issue is particularly relevant to employers here in the city of Philadelphia, which recently passed a deeply flawed paid leave mandate that shows little regard for employers' size, industry, proximity to competitors in other jurisdictions, financial stability or any of the countless variables that distinguish businesses. Companies that operate on thin profit margins, particularly small businesses, may not have the cash flow to pay employees taking time off and the overtime pay for the employee filling in. A business may, for example, allow employees to trade shifts if someone needs time off; yet a policy like this is now deemed insufficient. An ironic feature of the new requirement in Philadelphia is that organized labor, which actively supported and campaigned for the ordinance, was also able to secure a special carve-out that exempts them from the law. This is one of numerous examples of the double standard that exists in local and state statute to benefit the labor community.

In general, the prospect of higher taxes, additional mandates on employers, higher costs to do businesses and a concern that the employer perspective is getting lost in key policy deliberations are all adding to trepidation within the business community.

Employers in general can be cautious by nature and that will likely hold true regardless of what government does or does not do. Our goal as an organization, and we hope the goal of the General Assembly, is for Pennsylvania to be governed by policies that foster an environment in which employers' caution is at least balanced by their optimism, which will leads to investment, expansion and job growth.

Again, thank you for the opportunity to testify. I would be happy to answer any questions.