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7 STEPS

on the Road to Economic Recovery

Key Recommendations to improve Washington's small business climate

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WPC's Center for Small Business focuses on improving Washington's small business climate by working closely with business owners and policymakers. The Center provides accurate information and analysis on the state's regulatory climate, tax structure, health insurance systems and more.

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An in-depth analysis of the results from Washington Policy Center's 2011 Statewide Small Business Conference

January 2012

7 Steps on the Road to Economic Recovery

Key Recommendations to Improve Washington's Small Business Climate

The U.S. economy is officially in recovery, but people in Washington state are still struggling. Traditionally, small businesses have led the way out of recession as entrepreneurs create jobs and stimulate the economy. Unfortunately small businesses have been especially hard hit by the recession. As financial markets dropped and consumer confidence plummeted, the lines of credit and new loans vital to small companies dried up. To spur Washington along the road to recovery, policymakers in Olympia need to create the best possible environment for opportunity, confidence and economic growth so that small business owners can begin hiring again.

Washington Policy Center uses the state government's definition of a small business as a company with fewer than 50 employees.[1] As such, small businesses are essential to the health of Washington's economy:[2]

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1 "Lead the Way: Small Business and the Road to Recovery," by Carl Gipson, Policy Brief, Washington Policy Center, 2010, page 2.

2 "Size of Firm Data, 1st Quarter 2011" Washington State Employment Security Department, September 2011, at www.workforceexplorer.com/aspdotnet/search/adSearch.aspx?quickSearch=size%20of%20firm.

- 96% of the state's 235,230 firms are small businesses
- Small firms employ 40% of the state's private sector work force
- Just over 1.1 million people work for small businesses in Washington
- In addition, about 387,500 people in Washington are self-employed[3]
- Washington has the third highest business start up rate and the second highest business failure rate in the country[4]

Despite the size and importance of the small business sector, these companies are struggling to survive, hampered by the confusing tangle of federal, state and municipal regulations. Washington entrepreneurs consistently find that state and local regulators impose significant obstacles to the realization of their goals. The staggering amount of regulatory red tape amounts to more than 100,000 requirements that a small business owner must know, understand and follow in order to run a business legally. The regulatory structure strangles small businesses, drives up the cost of entering the market, impedes job creation and needlessly increases prices for consumers.

To understand the daunting economic obstacles small business owners face every day, WPC convened the 2011 Small Business Conference at Bellevue College on September 15th, our fifth small business conference since 2003. Small business owners and policymakers from around the state gathered to discuss ways to overcome the recession, put Washingtonians back to work and improve the small business climate. In breakout sessions,

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3 "2009 Non-Employer Statistics, Washington," US Census Bureau, at www.censtats.census.gov/cgi-bin/nonemployer/nonsect.pl.

4 "Puget Sound Regional Competitiveness Indicators, 2008–2009 Update," Indicator 13: Business Starts and Closures, Prosperity Partnership, November 2008, pages 43–44, at www.psrc.org/assets/262/PPindicators2008-2009.pdf1.

conference attendees voted on the top seven policy measures needed to improve Washington's business climate.

This report presents these seven policy recommendations along with additional recommendations discussed and voted on by conference attendees. A complete list of recommendations is included at the end of this report. These practical ideas offer elected officials a way to increase economic vitality and foster success for the people of Washington state.

1. Workers' Compensation

Build on the voluntary settlement agreement proposal passed in the Senate.

For decades, Washington's industrial insurance system has been run as a monopoly by the state Department of Labor and Industries. A small number of businesses (often large firms) self-insure. But the vast majority of Washington's businesses are forced to buy insurance from the state, and over the years the business community has become jaded at the prospect of continuing this fractious relationship. Business leaders are pushing hard to open the system to private sector competition in hopes of lowering premiums and getting injured workers back on the job more quickly.

The number of workers' compensation claims has been falling for two decades, yet the cost of the system continues to grow at a high rate — affecting both businesses and employees. Rates increased by 2.3% in 2008, and then again by 3% in 2009. In 2010, as businesses struggled through the effects of recession, rates went up 7.6%. In 2011 rates were again increased by a massive

12%.[5] A state auditor report issued in December 2009 shed light on the shaky financial footing of the state fund, citing in particular the dramatic decline in contingency reserve funds for both the Accident and Medical Aid funds.[6] While the Department of Labor and Industries has attempted to keep rates low, the cost of workers' compensation keeps going up.

In 2011, the Senate addressed these rising costs with SB 5566, which would have overhauled Washington's entire workers' compensation system. Later the House passed a significantly watered down version of the Senate-passed bill, and it was this weaker version that was eventually signed into law. While House Bill 2123 represents a small step in the right direction, it only accomplishes half the savings that the Senate bill would have.

Key provisions of HB 2123 include a stay-at-work program, a cost-of-living adjustment freeze until June 2012, and the establishment of a rainy day fund. Most importantly the bill provides injured workers aged 55 and over the ability to choose a structured settlement agreement, receiving periodic payments over a set length of time rather than being enrolled indefinitely in the state workers' compensation program. The state estimates that these measures will save taxpayers $1.12 billion over four years.[7]

The stronger Senate version, SB 5566, on the other hand would have offered voluntary settlement agreements equally to all workers without an age restriction. The Senate bill would have

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5 "No Increase for Workers' Compensation Rates in 2012," Washington State Department of Labor and Industries, December 1, 2011, at www.lni.wa.gov/News/2011/111201finalrates2012.asp.

6 "Workers' Compensation Program," Washington State Auditor, December 31, 2009, at www.sao.wa.gov/auditreports/auditreportfiles/ar1002832.pdf.

7 "Workers' Compensation: A More Sustainable Program for Workers and Businesses," Governor Chris Gregoire, 2011 Legislative Briefing, at www.governor.wa.gov/priorities/budget/workers_comp_program.pdf.

allowed workers to settle their claim with a lump sum one-time payment which gives individuals the greatest degree of control over the money to which they are legally entitled and would have greatly reduced the administrative cost of the workers' compensation program.

According to the fiscal estimate accompanying the Senate bill, it would have saved $1.2 billion in just two years,[8] more than twice the taxpayer savings of the House bill. SB 5566 would have saved billions for the business owners of Washington state while empowering all injured workers to set the terms of receiving their own benefits.

2. Unemployment Insurance

Reform the displaced worker retraining program.

Washington's unemployment insurance system imposes the second highest per-employee cost in the nation largely because it awards such generous unemployment benefits.[9] Administrative costs for the workers' compensation program are up 82% in recent years and the state has increased tax rates by 50%. At the same time the number of claims has decreased, but costs are still soaring.[10] Rates are scheduled to drop in 2012 for the first time in five years, but not enough to combat the previous 50% increase.

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8 "Fiscal Note for ESB 5566," Office of Financial Management, State of Washington, March 30, 2011, at www.fortress.wa.gov/ofm/fnspublic/legsearch.asp?BillNumber=5566&SessionNumber=62.

9 "Workers' Compensation-Benefits Paid (2006)," *2010 Competitiveness Redbook,* WashACE, table 25.

10 "I-1082 Would Open Workers Comp Market to Private Insurers," by Lee Fehrenbacher, *Bellingham Business Journal*, September 2, 2010, at www.bbjtoday.com/blog/i1082-open-workers-comp-market-private-insurers/8574.

One component of unemployment insurance is the worker retraining program. Anyone who is currently receiving unemployment benefits, who has exhausted unemployment benefits within the last two years, or who is about to receive unemployment benefits is eligible for the retraining program. Displaced homemakers, individuals who were self-employed but are now jobless, and employees who are "vulnerable to dislocation" qualify as well. Those eligible receive tuition, books, fees, tutoring, and academic and career counseling through local community colleges for up to 4 1/2 years even if they only complete 50% of the credits for the classes in which they enroll.

While providing access to training is important, the current system is clearly problematic. In 2009 enrollment increased by 70% as unemployment numbers spiked. Currently 12,738 people are enrolled in colleges under this program, 181% of the 7,036 people allocated by the budget.[11] With this rate of overuse the program is clearly unsustainable.

Tightening enrollment requirements would ensure that only people who would most benefit from retraining have access to those limited funds. Individuals who are "vulnerable to dislocation" should not receive retraining benefits because they already have a job and there is no way of knowing whether or not they will lose it. Similarly, individuals should not have free access to retraining for a full two years after their unemployment benefits run out. If a worker is interested in further education, he should take advantage of the retraining program immediately upon losing his job. Most

11 "Worker Retraining – FTE Monitoring Report," Washington State Board for Community and Technical Colleges, at www.sbctc.ctc.edu/college/workforce/2009_10_wrt_enrollment_monitoring.pdf.

benefits last between 13 and 26 weeks.[12] Those weeks translate into one to two semesters of class time that an unemployed person could invest in studying through the retraining program.

These reforms would ensure that training assistance is available to workers who actually need it and who will take the education benefit seriously. Besides making sound economic sense, these reforms would promote a more efficient system which gets people back to work sooner and imposes less of a financial burden on the business community.

3. Tax Simplification for Small Businesses

Simplify sales taxes.

- Use "origin-based" as opposed to "destination-based" sales taxes
- Create a flat rate for out-of-state businesses

With the passage of SB 5089 in 2008, Washington state switched from an origin-based sales tax to a destination-based sales tax.[13] The goal was to level the playing field between "brick and mortar" businesses and online retailers. The result was a heightened tax complexity for everyone.

A destination-based sales tax requires retailers to collect taxes based on the location to which a product is shipped rather than where the product is sold. Washington's 2008 decision to implement a destination-based tax was part of a 44-state

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12 "Frequently Asked Questions about Unemployment Benefits," Employment Security Department, Washington State, March 29, 2011, at www.esd.wa.gov/uibenefits/faq/faq-ui.php.

13 "Destination Based Sales Taxes," Washington State Department of Revenue, at www.dor.wa.gov/Content/FindTaxesAndRates/RetailSalesTax/DestinationBased/MoreSST.aspx.

agreement aimed at online retailers who avoid collecting sales tax from their customers.[14] In 1992 the U.S. Supreme Court ruled that destination sales taxes put too much of a burden on businesses since every company would have to keep track of hundreds of different tax rules. By implementing destination tax at a state level, state governments hope to pave the way for a federal ruling requiring online retailers to utilize destination-based sales tax as well.[15]

Unfortunately the problem of keeping track of multiple sales tax laws is now transferred to every business. This is a particular problem for small businesses. A company which sells products in Seattle must follow a whole new set of tax laws in order to sell products in Spokane or out of state. The time and expertise required to keep track of all the different sales taxes prohibits small businesses from expanding into new markets beyond their local tax jurisdiction. As such, small business owners recommend returning to the origin-based sales tax system which only requires them to be responsible for the tax laws where their business is located.

Similarly small business owners suggest a flat-rate tax for out-of-state businesses in order to simplify the taxation process. Rather than requiring sellers to calculate a separate tax amount for every state in which they operate, there should be a single fixed tax rate for selling to a company or individual across state lines.

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14 Colorado is a non-participating state. Alaska, Delaware, Montana, New Hampshire and Oregon do not have sales taxes. The District of Columbia is a participating member. See “Streamlined State Status 08-01-11,” Streamlined Sales Tax Governing Board, Inc. at www.streamlinedsalestax.org/uploads/images/state%20map%2008_01_11.jpg.

15 “Sales Taxes on the Internet,” Nolo: Law for All, at www.nolo.com/legal-encyclopedia/sales-tax-internet-29919.html.

4. Regulatory Reform

Review environmental regulations to ensure Washington rules do not impose a greater burden than federal regulations.

Federal environmental regulations are tough, imposing costly requirements on businesses across the country. Sometimes, however, Washington state's environmental regulations are even stricter, creating more bureaucratic red tape which companies must navigate in order to do business. Washington's added regulations translate into higher costs compared to the business climate in other states. Many large companies can more easily absorb the cost of regulations or simply shift their operations to another state, but meeting each new requirement is a struggle for Washington small business owners. When Washington's regulations are so much stricter than those of other states, Washington businesses are forced to operate at a severe competitive disadvantage.

Small business owners are concerned that in an effort to cultivate a public image of being concerned about the environment, state policymakers are ignoring both the actual success of environmental policies and their real-world economic impact. The 2005 bill requiring schools and state buildings to meet strict "green" building rules is just one example of a policy that requires businesses and taxpayers to pay for a failed approach.

"Green" building boosters said the new school buildings would save so much energy the higher cost of their construction would be paid back in just two years. Instead, most of the "green" buildings failed to save energy, using 15% to 52% more energy than similar non-green schools located in the same district. The cost of building under the narrow "green" rules was also higher than expected, about $816,000 more. Even assuming the new "green" schools are 15% more energy efficient, it would take 102 years — five times the life of the building — to pay for the cost of the "green" mandate.[16]

Similarly, the state's biofuel policy has not succeeded in replacing fossil fuels with biofuels, nor has it had much effect on reducing carbon emissions. Instead it has added to businesses' regulatory burden, and created more subsidies which businesses and taxpayers must fund. These examples are a reminder to legislators that every new environmental regulation comes with increased costs for businesses and taxpayers.

5. Health Care

Limit cost increases through effective tort reform.

The medical liability system is complicated and it currently fails to meet its two objectives of deterring medical negligence and compensating injured patients. The American Medical Association considers Washington one of a number of states facing a medical liability crisis. Most doctors in Washington must purchase expensive insurance policies to protect themselves against frivolous malpractice lawsuits, a large expense which drives up the cost of health care for everyone.

At the same time, average jury verdicts and average settlement claims have been steadily increasing. Washington has joint and several liability laws which hold every defendant in a medical

16 "Five Years of Environmental Policy in Washington State: Are we Making a Difference," by Todd Myers and Brandon Houskeeper, Policy Brief, Washington Policy Center, 2010.

malpractice lawsuit potentially responsible for paying the total cost of a jury award to a patient, regardless of how small that defendant's role was in actually causing the patient's injury.

There are many ways to address this systemic health care problem. Washington should follow the examples of California, Texas and other states in capping the amount of noneconomic damages that can be awarded by a jury to $350,000. Injured patients would still be fully compensated for their medical costs and loss of income. Caps on noneconomic costs, however, have proven successful in reducing the cost of litigation and speeding compensation payments. Washington should also eliminate its joint and several liability laws, ensuring that physicians are only held liable for their own medical decisions and actions, not for harmful acts committed by others.

In addition to limiting legal costs, broader, long-term solutions include establishing a schedule of damages, creating "early offer" programs for injured patients and introducing specialized medical courts. Washington policymakers should also strengthen the effectiveness of the state's Medical Quality Assurance Commission to ensure that the few substandard physicians are barred from practicing medicine in Washington.[17]

Keeping health care costs low is particularly important for small business owners. Providing employee health care is a significant business expense. If viable tort reform were enacted it would significantly slow the rising cost of health care coverage, freeing businesses' income that could be invested in growth and job creation.

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17 "Policy Guide for Washington State," 3rd Edition, Paul Guppy, editor, Washington Policy Center, 2008, page 113, at www.washingtonpolicy.org/pages/policy-guide-washington-state.

6. Transportation

Do not increase traffic congestion by cutting lane capacity.

Traffic congestion in the Puget Sound region is bad and getting steadily worse. Traffic snarls keep workers away from their families, slow the speed of vital freight transportation and drastically reduce mobility in the area. Despite paying ever-increasing prices for transportation, the Seattle metro area is increasingly congested. Policymakers should adopt policies that reduce traffic congestion rather than manipulate people into abandoning their cars.

Most of Seattle's transportation budget is used for vehicle alternatives such as mass transit and bicycle lanes, despite the fact that only 15% of commuters use those systems. There are many measures to combat this problem, but the small business community was most concerned that policymakers do no further harm to people's ability to get around.

Many of Seattle's road plans are not aimed at increasing capacity, but actually reduce capacity in an effort to coerce people to give up driving. For example, the number of unrestricted highway lanes in Seattle will actually decrease in the next 20 years despite projected population and employment growth.

This is a pattern seen throughout Seattle as the city replaces traffic lanes with bike-only restrictions, pours more tax money into a public transit system that few people use, and fails to address growing traffic congestion. Small business owners realize traffic policies which limit lane capacity in an already congested city will only create one more obstacle to running a successful business. It also means more Seattle residents will travel out of the city to areas where traffic flows are faster and parking is free, leaving fewer customers for urban neighborhood businesses.

7. Mandatory Paid Sick Leave

Do not follow Seattle in imposing a statewide sick leave requirement.

The Seattle City Council recently imposed a paid sick leave mandate on all companies doing business within the city limits. Small business owners across the state have expressed concern over the added financial burden this legal mandate puts on employers and are anxious that if it has to stay in place, it remain a Seattle-only law.

There is already a wide array of existing laws that allow workers to take time off (some of which is paid) to care for families, attend to personal medical needs, and take maternity or paternity leave. Estimates vary, but the mandate could cost up to $90 million in imposing new regulations already required by other laws. The law also affects businesses outside Seattle which have any operations within the city limits. Any employee who works more than 240 hours in a calendar year within the city will be entitled to mandatory paid sick leave.

This includes freight truckers who spend many hours stuck in Seattle traffic regardless of where their companies are actually located. It will also include employees who commute between two offices, one of which is within the city limits, even if the main office is outside the city. The burden of tracking how many hours a worker spends in Seattle creates a strong incentive for companies to keep their employees out of Seattle if at all possible.

This one-size-fits-all mandate prevents businesses from offering more cost-effective benefits, such as telecommuting or a flexible work schedule, to meet the needs of employees. The new mandate simply creates more regulations for businesses to follow and increases the cost of doing business in Seattle. It should not be implemented statewide.

Further Recommendations

2011 conference attendees reported that these seven recommendations, if adopted, would do the most to improve Washington's business climate. Following is the complete list of recommendations provided by conference attendees.

Workers' Compensation

- Build on the voluntary settlement agreement proposal that passed in the Senate
- Do not raise rates in 2012 since Labor and Industries department funds are in surplus[18]
- Increase fraud prevention and investigation efforts

Unemployment Insurance

- Reform the displaced worker retraining program
- Implement a web-based portal to allow employers to access claims data, including current contact information for unemployed workers (similar to the system used by Labor and Industries managers)
- Educate small business owners about the "shared work program"

18 This policy recommendation was adopted in November 2011.

Tax Simplification for Small Businesses

- Simplify sales taxes:
    - Use "origin-based" as opposed to "destination-based" sales taxes
    - Create a flat rate for out-of-state businesses
- Levy business taxes on net revenue vs. the current Business and Occupation tax on gross receipts
- Unify state and local business licensing to create a master business licensing system

Regulatory Reform

- Review environmental regulations to ensure Washington rules do not impose a greater burden than federal regulations
- Lawmakers should not grant general rule-making authority to agencies, but rather they should be specific about what rules are to be imposed on people
- Implement the State Auditor reports on regulatory reform
- Include sunset provisions for all new regulations

Health Care

- Limit cost increases through effective tort reform
- Reduce costs by reducing the number of state-imposed health care mandates
- Repeal the 2010 federal health care law

Transportation

- Do not increase traffic congestion by cutting lane capacity
- Protect highway tolls and taxes for highway purposes

- Make congestion relief a state policy goal
- Implement performance-based budgeting on transportation projects

Mandatory Paid Sick Leave

- Do not follow Seattle in imposing a statewide sick leave requirement
- The state should pre-empt local government regulations on labor laws
- Require business impact statements on laws like mandatory paid sick leave

Conclusion

The purpose of Washington Policy Center's Statewide Small Business Conference and this report is to provide policymakers, government agency managers and media with a guide to the important issues affecting small business owners. Too often policymakers act without considering the impact of their decisions on the owners of "mom-and-pop businesses," even though those are the very businesses disproportionately hampered by regulations and taxes.

Fortunately, policymakers sometimes listen and respond to business needs. In November 2011 one of the recommendations from WPC's Small Business Conference was adopted by the Department of Labor and Industries. Following small business owners' suggestion, the agency decided not to raise workers' compensation rates in 2012, leaving business owners more opportunities to invest, hire and grow. We hope to see many similar success stories ahead.

It is essential for both local and state leaders to recognize the vital link between the success of small businesses and of the state economy in general. Small business owners are acutely aware of the effects of the economic recession and they are strongly motivated to see the economy grow. Small business growth has led the way out of past recessions, and new investment and hiring by small business owners are essential to moving today's economy beyond the current weak recovery to long-term economic prosperity.

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This report was compiled and edited by Paul Guppy, Vice President for Research, and Caitlin Kincaid, who served as a research assistant in 2011, following WPC's 2011 Statewide Small Business Conference.

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