

Improving Washington's Small Business Climate

WHERE DO WE GO FROM HERE?

A collage of yellow road signs with black arrows pointing in various directions, set against a blue sky background. The signs are layered and partially overlapping, creating a sense of movement and choice. The background is a clear blue sky with a few wispy clouds.

A report by and for small businesses in Washington state
from Washington Policy Center

FEBRUARY 2013

WHERE DO WE GO FROM HERE

Introduction

Every two years, Washington Policy Center joins with business groups and chambers of commerce around the state to host a series of Regional Small Business Forums. These forums bring WPC researchers, policymakers and small business owners together to identify and discuss real solutions to the policy problems facing our state's business community.

In 2012, WPC hosted Regional Small Business Forums in Chelan, Spokane, Bellingham, Anacortes, Tri-Cities, Yakima, Vancouver and Tacoma. Over 600 small business owners attended the forums and heard from panels of experts on issues such as tax policy, workers' compensation, health care reform and government regulations.

Forum participants were asked to complete an informal survey during the events, identifying and prioritizing the issues they say have the greatest impact on their small business. They then recommended practical reforms that would improve our state's business climate. The survey responses reflect the longstanding issues that are often cited as evidence of Washington's weak business environment.

Background

The state of Washington defines a small business as any entity, such as a sole proprietorship, corporation or partnership, that is owned and operated independently of other businesses, and that has fewer than 50 employees.¹

¹ Revised Code of Washington (RCW) 39.29.006, Definitions, at apps.leg.wa.gov/rcw/default.aspx?cite=39.29.006.

As of the first quarter of 2011, there were about 226,700 registered businesses in Washington with fewer than 50 employees. In contrast, there were about 8,600 registered business with 50 or more employees.² These 226,700 small businesses in Washington employ 31% of the state's non-government workforce. According to the latest information, businesses with fewer than 50 workers employed approximately 868,736 private-sector workers.³

The importance of these small businesses to Washington's economy is significant. Small businesses:

- Represent 96.3% of all registered businesses in Washington⁴
- Employ 31% of all private-sector employees⁵
- Paid over \$1 billion in Business & Occupation (B&O) taxes in 2011⁶

Firms with fewer than 20 workers pay \$17 billion annually to their employees, or 15.33% of total state payroll.⁷ These small businesses are the engine that drives our national and state economies. They face many obstacles to success in Washington's difficult business climate. The result is a routinely high "business churn" ranking for our state. According to the state Department of Revenue (DOR): "It is generally accepted that Washington has among the highest rates of business churn in the nation. The SBA has

² Employment Security Department, at <https://fortress.wa.gov/esd/employmentdata/reports-publications/industry-reports/firm-size>; and email from ESD Labor Market Information Center, available upon request.

³ Employment Security Department email, Michael Moores, Research Analyst, July 12, 2012; available upon request.

⁴ Employment Security Department, at <https://fortress.wa.gov/esd/employmentdata/reports-publications/industry-reports/firm-size>; and email from ESD Labor Market Information Center, Carolyn Trip, Management Analyst, Labor Market Information Center, Labor Market & Economic Analysis, available upon request.

⁵ Employment Security Department email, Michael Moores, Research Analyst, July 12, 2012; available upon request.

⁶ Department of Revenue email, Shane Morgan, Research & Fiscal Analyst, August 3, 2012; available upon request.

⁷ "Employer Firms, Establishments, Employment and Annual Payroll by Firm Size, and State, 2009," Small Business Administration, at www.sba.gov/sites/default/files/static_stmsa.xlsx.

developed a widely published rank of states in order of startups and closures and consistently places Washington in the top 10 for both.”⁸

According to the latest data, Washington ranks ninth in businesses starts and 11th in business closures (2010).⁹ In 2006, Washington ranked third in business starts and second in closures.¹⁰ Since no major reforms in the state’s business climate were made between 2006 and 2010, it is difficult to discern the reasons for Washington’s decrease in business closures. One theory is the improved ranking in business closures may be attributed to the fact many other state economies have fared far worse than Washington’s during the Great Recession, resulting in dramatically higher-than-normal business closure rates nationally and improving Washington’s standing only by comparison.

Despite the improvement, Washington still boasts one of the nation’s highest business closure rates. While many factors account for this high failure rate, a 2007 Department of Revenue study on the business survival rate in Washington found that “taxes and costs of complying with government regulations are factors that contribute to business failure because most small businesses are not profitable in the early years.”¹¹

The DOR study is evidence that policymakers around the state realize there is a small business problem that has been created by government, yet many officials are unsure of the specific issues or the best solutions. Ironically, some of these same policymakers are often well versed in and responsive to the issues that are important to large businesses.

Lawmakers are quick to advocate policy reforms to improve the business climate whenever Boeing announces new jobs might be created in a state other than Washington because our business climate “sucks,” but

⁸ “Small Business Survival: A Joint Report to the Governor,” by the departments of Community, Trade and Economic Development; Employment Security; Labor and Industries; and Revenue; October 5, 2007, at www.dor.wa.gov/docs/reports/BusinessSurvivalReportOct2007.pdf.

⁹ “2013 Competitiveness Redbook: Key Indicators of Washington State’s Business Climate,” Washington Alliance for a Competitive Economy, September 2012.

¹⁰ “Puget Sound Regional Competitiveness Indicators,” by the Puget Sound Regional Council, November 2008, at www.psrc.org/assets/262/PPindicators2008-2009.pdf.

¹¹ “Small Business Survival: A Joint Report to the Governor,” by the departments of Community, Trade and Economic Development; Employment Security; Labor and Industries; and Revenue; October 5, 2007, at www.dor.wa.gov/docs/reports/BusinessSurvivalReportOct2007.pdf.

the same lawmakers are markedly less responsive when small businesses, who don't have the option of relocating to another state, repeatedly echo Boeing's sentiments.¹²

The problems of large businesses and small businesses are actually very similar. The primary difference is the impact of those problems on their profitability. Small businesses are more likely to suffer from the harmful effects of complex tax and regulatory policies, and most small businesses cannot afford lawyers and consultants to help them navigate the twisting labyrinth of government red tape. This translates into much higher costs for small business owners compared to large businesses.

The Small Business Administration reports that very small firms (those with fewer than 20 employees) spend 36% more per employee than do larger firms in order to comply with just the federal regulations; a firm with fewer than 20 workers spends about \$10,585 per employee to comply with federal regulations, whereas a firm with over 500 workers spends only \$7,755 per employee.¹³

Like large businesses, small businesses are adversely affected by high taxes, high minimum wage rules and expensive regulations. In fact, a recent report by the Washington Roundtable, a nonprofit public policy organization comprised of executives from some of the state's biggest private-sector employers — Starbucks, Microsoft and Boeing, to name a few — identified many of the same issues as the small business community in ranking the state alarmingly low in areas vital to a competitive business climate.¹⁴

The Washington Roundtable study gave Washington poor marks for our state's high workers' compensation and unemployment insurance costs, as well as our high overall business tax burden. Not surprisingly, these are all longstanding complaints heard from the small business community, as confirmed by WPC's most recent small business survey.

¹² Comment by Boeing Commercial Airplane President Alan Mulally, "When Boeing talks, will lawmakers listen?" *Port Orchard Independent*, November 18, 2008, at www.portorchardindependent.com/opinion/34616039.html.

¹³ "The Impact of Regulatory Costs on Small Firms," by Nicole V. Crain and W. Mark Crain for SBA Office of Advocacy, September 2010, at archive.sba.gov/advo/research/rs371tot.pdf.

¹⁴ "Benchmarks for a Better Washington," Washington Roundtable, April 2012, at www.waroundtable.com/benchmarks/.

Policy Analysis

At the eight regional forums, the more than 600 participants were asked to identify and rank the issues of greatest concern to their small business, and for their policy recommendations for improving our state's business climate. This informal survey provides valuable insight into the problems small business owners face on a daily basis.



SMALL BUSINESS SURVEY

Rank the issues most important to you and your business:

1. Workers' compensation costs
2. Tax policy
3. Health care
4. Regulations

Among policy recommendations for tax policy, rank your favorite:

1. Higher/lower tax credits for your industry
2. Replace B&O with a personal or business income tax
3. Repeal state and federal estate taxes
4. Increase the B&O tax exemption

Among policy recommendations for health care, rank your favorite:

1. Authorize low-cost, mandate-light health coverage
2. Reduce/freeze state's health care mandate
3. Allow the interstate purchase of health coverage
4. Repeal federal health care reform law

Among policy recommendations for workers' compensation reform, rank your favorite:

1. Expand structured settlement agreements
2. Reduce workers' compensation benefits
3. Allow private insurers to compete with the state

If taxes were lower, would you:

1. Save for a rainy day
2. Hire more employees
3. Reinvest into more assets (land, machines, etc.)

Which state regulations have the biggest impact on your business?

1. Minimum wage
2. Workers' compensation
3. Unemployment insurance
4. Environmental regulations

These rankings reflect the prioritization of the issues by all survey respondents. We also calculated the survey results for each of the eight regions in which a small business forum was held. Those regional breakdowns are available upon request.

In sum, our state's high workers' compensation costs and high minimum wage continue to dominate small business concerns. Business owners also worry about the high cost of unemployment insurance, minimum wage rules and other business taxes like the B&O. Also important was concern over increasing health care costs. These concerns are not without merit.

Washington ranks first for having the nation's highest workers' compensation benefits paid to injured workers.¹⁵ To pay these generous benefits, businesses have shouldered a massive 66% increase in the workers' compensation tax they pay to the state over the past 10 years, and they now face an additional 40% increase over the coming decade.¹⁶ WPC recommends expanding the age-restricted workers' compensation structured settlement reforms passed in 2011. This change would allow voluntary settlements for all injured workers, as is done in 44 other states, not just for those aged 55 and older.¹⁷

Our state's average yearly unemployment tax of \$803 per full-time employee is the fifth highest in the nation; the national average is about half that amount, \$451.¹⁸ The maximum weekly benefit amount of \$604 is the second highest in the nation, and the average weekly benefit of \$374.81 is the fifth highest (the national average is \$303.85).¹⁹ WPC recommends reducing the costs of the unemployment insurance system by reducing overly generous benefits to bring Washington state more in line with the national average.

¹⁵ "2013 Competitiveness Redbook: Key Indicators of Washington State's Business Climate," Washington Alliance for a Competitive Economy, September 2012.

¹⁶ "L&I's 10-Year Plan: A Double Digit Tax Hike," by Erin Shannon, Washington Policy Center, September 21, 2012, at www.washingtonpolicy.org/blog/post/li's-10-year-plan-double-digit-tax-hike.

¹⁷ "The Time Has Come to Fix Workers' Compensation," Policy Brief, Washington Research Council, March 8, 2011, at www.researchcouncil.org/docs/PDF/WRCBusinessClimate/2011WorkersCompBriefFinal.pdf.

¹⁸ "2013 Competitiveness Redbook: Key Indicators of Washington State's Business Climate," Washington Alliance for a Competitive Economy, September 2012.

¹⁹ *Ibid.*

Washington has the highest minimum wage of any state, at \$9.19 per hour.²⁰ The state's minimum wage automatically increases every year based on the cost of living increase for the Puget Sound area. WPC recommends de-coupling automatic minimum wage increases from the Puget Sound-area Consumer Price Index to reflect the true cost of living across the state, delaying automatic increases in years when state unemployment is higher than the national average, and allowing temporary training wages for young or inexperienced workers.

When considering which states have the highest overall business tax burden — state and local — Washington ranks ninth. Particularly worrying is that Washington's business tax burden is considerably higher than that of most Western states, especially compared to neighboring Oregon (32nd) and Idaho (46th).²¹ WPC recommends centralizing and streamlining the administration of the burdensome Business & Occupation tax to provide businesses one point of contact to pay state and local B&O taxes. WPC also recommends replacing the B&O tax with a simpler, fairer Single Business Tax.²²

Washington ranks eighth in state-imposed health insurance mandates. The state imposes 58 mandates, while Oregon and Idaho impose 44 and 13 respectively.²³ Numerous studies demonstrate a strong correlation between the number of mandates, higher health coverage costs and increases in the uninsured population. WPC recommends authorizing low-cost, mandate-free health insurance, requiring an independent cost-benefit analysis of existing health care mandates and adopting a moratorium on new mandates.

Interestingly, when offering solutions to the high ranking concerns of the workers' compensation and health care costs, the vast majority of business owners did not advocate ending the state monopoly on workers' compensation by allowing competition from private insurers, nor did they advocate repeal of the federal Affordable Care Act.

²⁰ Ibid.

²¹ Ibid.

²² "Replacing the Business and Occupation Tax with a Single Business Tax," by Jason Mercier and Carl Gipson, Policy Brief, Washington Policy Center, May 2010, at www.washingtonpolicy.org/sites/default/files/B&OPB.pdf.

²³ "Health Insurance Mandates in the States 2011," by Victoria Craig Bunce, Council for Affordable Health Insurance, 2012, at www.cahi.org/cahi_contents/resources/pdf/MandatesintheStates2011ExecSumm.pdf.

Instead the top recommendations focus on reducing the burdens on business by more moderate means. In the case of workers' compensation, the top recommendation is to expand structured settlement agreements to more injured workers, followed closely by reducing workers' compensation benefits. Regarding health care, the top recommendation is to reduce the number of state-imposed mandates on health care coverage.

Also of interest is the relatively strong support for the idea of replacing the state's burdensome and unfair B&O tax, which charges a business on gross receipts regardless of profitability, with a personal or business income tax. While not the top pick of survey respondents, it is a close second. This could reflect business owners' mounting frustration with the increasingly complex and inequitable B&O tax levied by the state and 38 cities

Conclusion

Former Governor Gregoire highlighted her last year in office by focusing on ways to improve the state's small business climate. She declared, "Small businesses are the backbone of Washington's economy" and noted that, "It's small businesses that employ the vast majority of our workers.... If we can make it easier and cheaper for them to do business, they can afford to add more employees. This is the key to our economic recovery and to our social fabric."²⁴

Governor Gregoire is right. Small business growth is the engine of economic prosperity. Our state's small businesses represent more than 96% of companies in Washington, and they employ over one-third of the private-sector workforce. History has taught us these businesses should be leading our economy out of the Great Recession. Traditionally the jobs created by entrepreneurs are a major catalyst for economic growth and revitalization during times of economic stress.

Unlike previous recessions, job creation by the small business community has been anemic, and that is bad for the economy, for the government and for our state in general.

²⁴ "Gov. Gregoire announces strategy to spur small business growth," press release, Office of the Governor, January 5, 2012, at www.governor.wa.gov/news/news-view?pressRelease=1832&newsType=1.

Small business owners know what they need to be successful. The results of WPC's small business survey are a tool for lawmakers to begin improving the state's business climate. None of the policy recommendations are new, nor are they revolutionary. They are commonsense, practical ideas that have long been supported by the business community as ways to foster an environment where businesses large and small can grow, thrive and create the jobs that will spur expansion of our state's economy.

About the Author



Erin Shannon is director of WPC's Center for Small Business. Before joining Washington Policy Center, she was the public relations director of Washington state's largest pro-small business trade association, and was formerly a legislative correspondent for U.S. Congressman Randy Tate in Washington, D.C. Over the past 15 years, Erin has appeared regularly in print, broadcast and radio media. She was a recurring guest on ABC's "Politically Incorrect with Bill Maher" until 2002. Erin has served as the spokesperson for several pro-small business initiative campaigns including Referendum 53, repealing increases in unemployment insurance taxes; Initiative 841, repealing the state's ergonomics rule; and Initiative 1082, to end the state's monopoly on workers' compensation. She holds a bachelor's degree in political science from the University of Washington.

About Washington Policy Center

Chairman

Greg Porter

President

Dann Mead Smith

Vice President for Research

Paul Guppy

For more information, contact Washington Policy Center:

PO Box 3643
Seattle, WA 98124

p 206-937-9691
f 206-624-8038

wpc@washingtonpolicy.org
www.washingtonpolicy.org

Washington Policy Center is a 501(c)(3) non-profit research and education organization that promotes sound public policy based on free-market solutions. Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body.

© Washington Policy Center, 2013