

LEAD THE WAY

SMALL BUSINESS & THE ROAD TO RECOVERY

POLICY
RECOMMENDATIONS
TO IMPROVE THE
SMALL BUSINESS
CLIMATE IN
WASHINGTON STATE



WRITTEN BY
CARL GIPSON



Small Business and the Road to Recovery

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by Carl Gipson
Director, WPC's Center for Small Business
January 2010

Contents

Introduction: The Importance of Small Businesses in the Economy	1
Health Care Reform	3
Workers' Compensation Reform	6
Technology Issues	10
Regulatory Reform	13
Environmental Regulations	15
Unemployment Insurance	17
State Tax Issues	20
Competitiveness Issues	22
Conclusion	25
About the Author	26



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Introduction: The Importance of Small Businesses in the Economy

In late 2009, economists began predicting the reemergence of the American economy. The Dow had regained some of its wealth lost in the aftermath of the financial market meltdown of 2008 and the credit markets were beginning to thaw.

In fact, the hit to the financial markets was so bad that the Dow lost approximately 53% of its value in 18 months (October 2007 to March 2009). Similarly, credit markets froze up once the large financial firms, such as Lehman Brothers, were allowed to fail. As a result, credit and loan opportunities for small businesses dried up. Almost 18 months after the collapse of the financial markets, only now are small businesses being considered for borrowing or credit.

However, the unemployment rate continues to climb, both nationally and in Washington state. The latest numbers put the national jobless rate at 10% and Washington's at 9.2%. Both rates are almost double the unemployment rate from 18 months prior. And while parts of the economy seem to be turning up, because the unemployment rate is a lagging economic indicator, the rate will continue to worsen for the next several months. In fact, the national rate is expected to peak at around 11%.

Since the end of the last recession in 2001, Washington's job growth outpaced national trends from 2003 through 2008. But since the financial turmoil of 2007 and the market collapse of 2008, Washington has lost 162,000 jobs.¹

According to the Puget Sound Regional Council, Washington continues to be a state with strong entrepreneurial activity, as the state ranks 3rd in business starts for the year 2006 (latest data available). However, Washington continues to be near the top in business terminations – ranking 2nd overall in 2006, after two years at number one. In the category of business churn – the sum of starts and closures as a percentage of all firms – Washington ranks 3rd.²

Not every business termination can be chalked up to government policies such as a tough regulatory climate or unfair tax system, but with the right

¹ "Washington State Employment Situation Report for November 2009," Employment Security Department, at www.workforceexplorer.com/admin/uploadedPublications/1886_laus_historical.xls

² Indicator 13: Business Starts & Closures, "Puget Sound Regional Competitiveness Indicators, 2008-2009 Update," Prosperity Partnership, November 2008, pgs 43-44.

policies, the state's termination rate could be much lower while maintaining a strong business startup rate.

Policy Implications

Small businesses often lead the way out of recessions. During the 2003-2004 recovery period from the recession from the early 2000s, businesses with fewer than 500 employees hired almost 1.9 million workers, while businesses with more than 500 employees laid off over 200,000 workers.³

In Washington, using both the state government's and Washington Policy Center's definition of small business (fewer than 50 employees), small businesses make up 96% of all registered businesses while employees of small businesses account for 41% of the state's workforce.⁴

Every recession is different and because of the double blow of the crumbling financial markets and historic housing slump small businesses were disproportionately affected – as many small businesses are funded by second or third mortgages.

It is therefore important that policies considered by state and local officials do not add a burden to the struggling small business community. It is in the best interest of state policymakers and elected officials to create and maintain a business climate that encourages formation and growth of small businesses and reduces state-imposed barriers to their success.

Small Business History and Mission

In 2001, Washington Policy Center launched the Small Business Project to provide small business owners with a way to air their concerns and frustrations with regulatory policies and other issues they face running a business in our state. The first phase of the Project included fourteen small business roundtables in all regions of the state. WPC also formed important partnerships with more than sixty statewide and local business organizations, trade associations and chambers of commerce.

The second phase of the Project was to establish a biennial statewide conference. The Statewide Small Business Conference, first held in 2003, brought hundreds of small business owners to one location to recommend and prioritize policy changes in eight different areas. The results of the Conference were presented as a report to the State Legislature at the next legislative session.

In the years since the 2003 Conference, WPC has held conferences in 2005, 2007 and 2009 as well as regional roundtables around the state during the even-numbered years. Each conference produced a report presented to the legislature and each time many of the policy recommendations were turned into legislation, with several enacted into law.

The goal of this report, similarly, is to present policymakers 24 ideas on how to improve the small business climate in Washington state. Strong leadership and a focus on policy that will support small businesses are required to implement these reforms.

³ Table 2: Net Job Change by Firm Size, 2003-2006 (Nonfarm), "Small Business Profile," Small Business Administration Office of Advocacy, October 2009.

⁴ "Number of Firms and Employment, by Size of Firm and County For All Ownerships, including Multiple Establishments, First Quarter 2009," Department of Revenue. Available at www.workforce-explorer.com/admin/uploadedPublications/9944_1Q09_SizeofFirm.xls

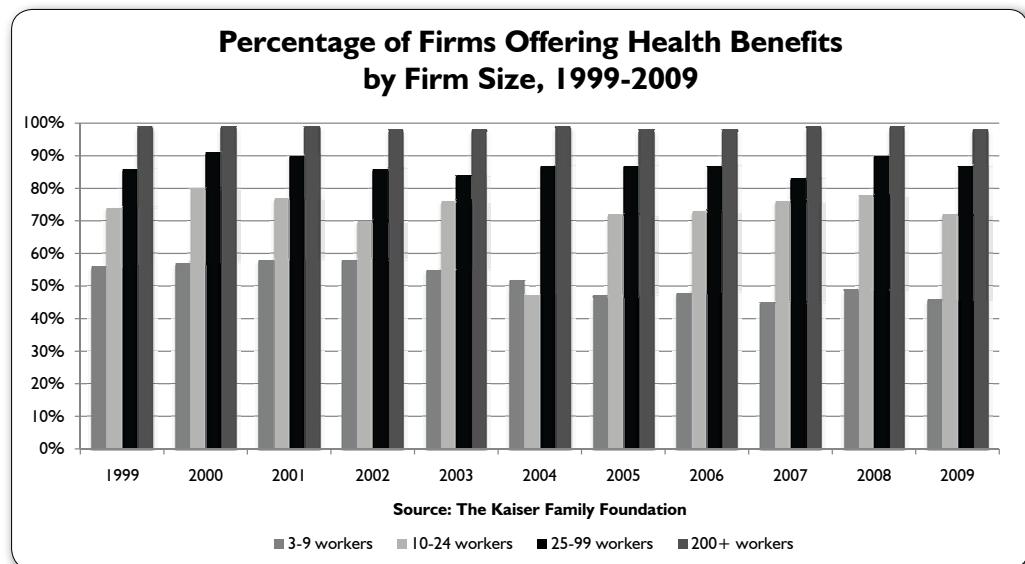
The small business owners who attended WPC's Statewide Small Business Conference in November 2009 suggested all of the recommendations in this report. The goal of this report is to provide a source of detailed analysis of the top three recommendations from each breakout session. These recommendations offer a path that elected officials can take to ensure Washington's small business community, and our state as a whole, increases in economic vitality and success.

HEALTH CARE REFORM

Top Three Recommendations:

1. Medical malpractice reform
2. Allow purchase of health insurance across state lines
3. More consumer involvement in health care decisions

Background



Health care expenses continue to rise each year at a rate nearly double the rise in our gross domestic product (GDP). With our current programs, by the year 2050 we will spend fully one-third of our GDP on medical care. From a basic economic standpoint, this level of spending is not sustainable.

The rising cost of medical insurance has detrimental effects on small businesses in particular. A small business is less likely to be able to afford health insurance for its employees, and prospective employees are less likely to work for a small firm that does not offer health insurance.

The Kaiser Family Foundation reports that the smallest firms – those with between three and nine workers – are most at risk. In 1999, 56% of firms with three to nine employees offered health benefits. That number dropped to 46% in 2009. Likewise, only 72% of firms with between 10 and 24 employees currently offer health benefits. The percentage grows as the firm size increases. Overall, however, only 60% of all firms, regardless of size, offer health benefits to employees, down from 66% in 1999.⁵

Washington's health care system is very complex and confusing because of the many federal, state, and local mandates, regulations and laws; and as

⁵ "Exhibit F: percentage of Firms Offering Health Benefits, by Firm Size, 1999-2009," *Employer Health Benefits 2009 Annual Survey*, Kaiser Family Foundation, pg. 5.

Congress inches towards finalization of national health care overhaul legislation confusion may heighten. The reforms published in this report are intended to help small businesses gain the necessary benefits they need to offer current or potential employees health insurance and to remain competitive with larger firms and out-of-state businesses.

I. Medical malpractice reform

Currently, individuals may file civil lawsuits against doctors, clinics and hospitals for unlimited amounts of money for breaches of duty that cause injury. This legal system has two primary purposes – deter doctors and other health care providers from acting negligently, and compensate injured people for the losses they have suffered.

Although not required by state law, most doctors buy malpractice insurance to protect themselves and their practices against expensive jury verdicts. The high cost of malpractice insurance contributes to the rising cost of health care, and is having a harmful effect on doctors, patients and payers.

The American Medical Association includes Washington on the list of states facing a medical liability crisis, threatening the viability of the medical community and the health of patients. This is the third malpractice crisis in 30 years, following the ones in the mid-1980s and the mid-1970s.

Although fewer medical malpractice claims have been filed in recent years, the monetary value of each claim is rising. Over the past ten years, the average jury verdict in Washington has increased by almost 70% and the average settlement cost has increased by over 50%. Likewise, the number of verdicts and settlements over \$1 million increased by tenfold in roughly the same time period. High jury awards are not isolated events; they influence future court cases as well as out-of-court settlements.

Higher claim costs are the primary reason for increased malpractice insurance premiums. Moreover, in Washington, because of joint and several liability rules, each defendant in a medical malpractice lawsuit is potentially responsible for paying the total jury award to a patient, regardless of how small that defendant's role was in causing the patient's injury.⁶

This rule encourages injured patients and their lawyers to seek full payment from the defendant with the "deepest pockets," not necessarily the one most responsible for causing harm.

Twenty-nine states have adopted some limitation on jury awards, primarily on noneconomic damages. Many states model their tort reform on California's Medical Liability Injury Compensation Reform Act (MICRA), enacted in 1975. MICRA caps noneconomic damages at \$250,000 and limits attorney fees based on a sliding scale.⁷

In 2003, Texas capped malpractice jury awards for noneconomic damages at \$250,000. As a result of this and other reforms, the state's largest malpractice insurance company cut its premiums by 35%, resulting in \$217 million in savings to doctors, and their patients, over a four year period.⁸

⁶ For more information on this issue, see "Medical Liability Reform: A Three-State Comparison," by Washington Policy Center. Available at www.washingtonpolicy.org/Centers/healthcare/policy-brief/05_johnson_medicalreform.html

⁷ For more information on the MICRA system in California, see "MICRA and Access to Health-care," by William G. Hamm PhD., et. al., November 2008.

⁸ "Why doctors are heading for Texas," by Joseph Nixon, The Wall Street Journal, May 17, 2008.

2. Purchase of health insurance across state lines

Although some of the cost drivers of health care are beyond the control of policymakers, there is one key factor which state policymakers directly control: the cost and impact of state-imposed mandates. Mandates are state laws listing benefits for specific conditions or services that every health insurance policy sold in the state must cover, whether insurance purchasers have requested the coverage or not.

Independent research shows that mandates can increase the cost of basic health coverage by about 20 to 50% overall, depending on the state, or by about 0.5-1.0% per mandate.⁹

Not all states are equal when it comes to the number of health insurance mandates attached to each insurance policy. Washington state now has 57 mandates, whereas Oregon has 40, Idaho 13, Alaska 32, etc.¹⁰ An extensive set of state-imposed restrictions on what consumers can buy would have a substantial impact on any industry. It is not surprising that these mandates have considerable impact on health insurance prices and availability in Washington.

Currently, state law makes it illegal for people in Washington to buy health insurance in another state, no matter how good a deal that policy might be for them. This prohibition does not apply to other types of insurance, like auto, homeowners and life insurance. Multi-state companies selling auto, homeowners and life insurance offer choice, good prices and quality service for one reason only; the consumer is in charge, and insurers know they have to please the customer, not government regulators or company benefits managers, in order to get business.

Greater market choice and better prices in health care are available across the country and easily available through the Internet. A report from PriceWaterhouseCoopers reports that among the “major factors that drive price increases are reduced provider competition...”¹¹

Small business owners recommended that lawmakers should remove the legal barriers and let their citizens tap into a nationwide market in affordable health care. Washington residents could select policies from states with fewer mandates, thereby decreasing costs and increasing choice in the marketplace.

3. Increasing consumer involvement in the health industry

The current system of employer-based health care coverage dates from the years when the federal government imposed wage controls during World War II. Since employers were barred from offering higher wages to attract workers, they began offering non-monetary benefits such as health care. In 1943, the IRS ruled that the cost of these benefits was a legitimate business expense, making health coverage fully tax deductible for businesses, but not for individuals.

That ruling, later confirmed by Congress, created four interconnected economic distortions in the health care market:

- It prevented patients from knowing the actual cost of the care they received

⁹ “Health Insurance Mandates in the States, 2009” by Victoria Craig Bunce, Director of Research and Policy, and J.P. Wieske, Director of State Affairs, Council for Affordable Health Insurance, March 2008.

¹⁰ Ibid.

¹¹ “The Factors Fueling Rising Health Care Costs, 2008” PriceWaterhouseCoopers, December 2008, page 3.

- It created the third-party payer problem, encouraging patients to demand care, regardless of whether it is necessary or cost effective
- It undermined the true understanding of health insurance. People tend to see their health benefits as a pre-paid service, not as a way of mitigating risk. People reason, “It’s a free benefit. I’ll use as much as I want”
- It caused health insurance to actually become health “maintenance” whereby it covers all health related activities, not just unexpected or catastrophic problems.
- In other words, the receivers of the benefit (patients) became disconnected from the marketplace of health insurance.

There are several ways to better involve health insurance consumers in the marketplace. One way is through changing the federal tax code to allow individuals to deduct their health insurance expenses just as businesses do. This will give employees the freedom to purchase their own insurance and will allow employers to decrease their overhead and potentially offer higher wages. It will provide larger insurance pools of many individuals, rather than a single, company-based pool. It will give employees a greater choice in type and amount of insurance coverage.

Another way to help reform the way consumers think about health care is to make health “insurance” true indemnity insurance. Instead of the current “insurance” system that covers every health related activity, the system should be reformed to work like other forms of indemnity insurance such as car and home. Just as no one has insurance to pay for the gas in their car or food in their grocery store, perhaps the health care industry could be reformed to move towards a system that focuses on catastrophes and emergency needs. Day-to-day expenses should be paid for out of pocket. The closest system currently allowed under federal and state law is Health Savings Accounts (HSAs).

HSAs are pre-tax deposits into an account set aside for routine health expenses. HSAs must be accompanied by a high deductible health plan, to cover catastrophic events. A greater emphasis on HSAs would help bring consumers back into the marketplace of decision-making, thereby alleviating the third-party payer problem that has removed the consumer from knowing how the market even works.

WORKERS’ COMPENSATION REFORM

Top Three Recommendations:

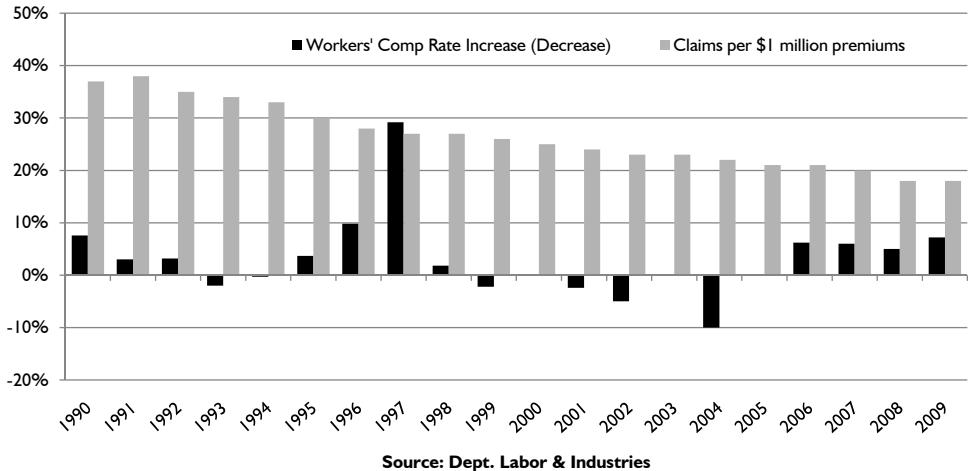
- 1. Introduce a competitive option**
- 2. Allow for compromise and release**
- 3. More aggressive claims management**

Background

The Department of Labor and Industries (L&I), which administers the state’s workers’ compensation program, is one of the largest agencies in state government, with more than 2,700 full-time staff and a biennial budget of just under \$600 million.¹²

¹² “2009-2011 Operating Budget as Enacted,” Office of Financial Management, <http://apps.leg.wa.gov/documents/billdocs/2009-10/Pdf/Bills/Session%20Law%202009/1244-S.SL.pdf>

Workers' Comp Rate Change and Claims per \$1 Million in Premiums since 1990



By law, only L&I is permitted to sell workers' compensation insurance in Washington, and virtually all businesses in the state are required to buy such insurance. A handful of larger businesses are allowed to self-insure, but all other businesses purchase their industrial insurance through the state monopoly program. The state program covers over 171,000 employers and 2.5 million workers, and it collected more than \$1.57 billion in L&I taxes from employers and employees in 2008.¹³

L&I also covers over 400 employers who self-insure and provide coverage for 870,000 workers, about one-third of all workers in the state.

The original purpose of the workers' compensation system was to provide secure and certain relief for workers in the event of an on-the-job injury. In return for joining a legally-mandated program, employers gained protection against the uncertainty of individual lawsuits brought against them by injured employees. For employers and workers, the system is intended to provide security, financial predictability and fair treatment.

But in recent years, businesses have become increasingly frustrated with the Department's tax increases – particularly during a very difficult recession. Every workers' compensation tax increase results in less take-home pay for employees or is passed on to consumers in the form of higher prices.

In the past ten years the workers' comp tax rate has risen over 50%, even with no increases in 2006 and 2007, while the number of claims actually decreased 52% during the same time.¹⁴ The average time loss claim in Washington is now up to 266 days – up 38% since 2001.¹⁵ And Washington has the second-highest benefits paid per covered worker in the nation.¹⁶

Small business owners at the Statewide Small Business Conference recommended three important reforms, both long-term and short-term, that can help reduce the cost and administrative headache of Washington's government-run system.

¹³ "2008 Year in Review, Washington's Workers' Compensation System," Department of Labor and Industries at www.lni.wa.gov/IPUB/200-015-000.pdf

¹⁴ PowerPoint Slide, "2010 Proposed Rate Discussion," at the Workers' Compensation Advisory Committee Meeting (September 21, 2009) at 53, available at: www.awbblog.typepad.com/files/wcac-presentation-9-15-09---final.pptx.

¹⁵ Ibid. at 45.

¹⁶ "Workers' Compensation-Benefits Paid (2006)," 2010 Competitiveness Redbook, WashACE, Table 25.

I. Introduce private competition into the industrial insurance arena

Washington is one of only four states that does not allow businesses to buy workers' compensation insurance in the private market. Only Ohio, North Dakota and Wyoming have similar monopoly systems. Unsurprisingly, prices have a tendency to rise when customers are required by law to buy a product from a single source. In 46 other states employers have a choice among many competing private providers, and in some states a state-managed fund offers yet another option for business. Small business owners believe increasing provider options through competition would help make workers' compensation more effective and less expensive.

Allowing private insurers to provide workers' compensation insurance would also introduce a new incentive for reducing workplace injuries. Because dangerous work environments and slow rehabilitation can be very expensive, private insurance companies in other states have developed extensive safety training programs designed to reduce accidents and workers' compensation claims. By working closely with their customers, insurance companies can dramatically reduce the risk of workplace injuries.

Washington's current monopoly industrial insurance system has a number of unique features that must be carefully considered in making such a change. Washington is one of the only states where workers pay into the insurance premiums. Also, industrial insurance premiums in Washington are based on hours of work, while most other states base premium rates on company payroll.

There have been several examples of states moving towards industrial insurance competition. In 1999, the state of Nevada began allowing private companies to provide workers' compensation insurance. Under the plan, private insurance companies are required to file regular loss cost reports with the National Council on Compensation Insurance (NCCI). Using these reports, NCCI sets the loss cost rates for all Nevada insurers. Final rates are then determined by each company based on three factors: loss cost, which is set by the state, administrative cost, which is competitive, and profit, which is also competitive.

The result of the Nevada experience is a system with vigorous competition, strong worker protections and a number of successful private providers.

Similarly, West Virginia approved the conversion of its industrial insurance system into a competitive marketplace in 2005 with the privatization of its state fund, which had been the sole workers' compensation provider. Since the market was opened to other private competitors in 2008, claim protests have fallen 68%, the overall appeals process was streamlined resulting in claim disputes being resolved in a shorter period of time. Overall premiums have dropped 30%, or more than \$150 million, and now 154 different workers' compensation insurance companies provide policies. Not only that, but 90% of all claims are ruled upon within the first 30 days.¹⁷

The state of Oklahoma is looking to privatize its state-run workers' compensation agency CompSource, which underwrites approximately 35% of the industrial insurance policies in the state and competes with private sector industrial insurance companies in a hybrid public-private competitive

¹⁷ "West Virginia Touts Switch to Private Workers' Compensation System," *Insurance Journal*, July 7, 2009, at www.insurancejournal.com/news/southeast/2009/07/07/102008.htm.

marketplace.¹⁸ Similarly, Colorado also considered legislation that would have sold its state-chartered workers' compensation provider.¹⁹

The experiences of other states in opening up the industrial insurance market to competition, or ending the burden of a state-run monopoly, shows that vigorous market competition would ease the heavy burden on Washington's small businesses and provide better protection for workers. As part of legalizing private workers' compensation insurance, the state could maintain its own program and provide an additional choice in the marketplace. The state program could downsize and instead serve as the "insurer of last resort" for firms that have difficulty getting the required level of coverage from private insurers.

2. Compromise and Release

Compromise and release is an option that allows the Department of Labor and Industries to pay out benefits to an injured worker immediately as a lump-sum payment based on how much the claimant would receive over his lifetime. In some cases this alternative can simplify the administrative requirements of a claim and allow an injured worker to have greater control over how to use his benefits. Some form of lump-sum payment is common in other states, providing a key alternative that reduces the cost and complexity of paying for a workplace injury.

The employer benefits from compromise and release (also referred to as a "structured settlement") because the company is relieved of the administrative cost of tracking payments to the injured employee, thus saving money by simply not dealing with a claim for the long term.²⁰

3. More aggressive claims management by L&I

Pilot studies by the Department of Labor and Industries show that using Centers of Occupational Health Excellence (COHE) to help injured workers lowers costs and gets employees back to work sooner. The Department says that the COHE model "bring[s] together local clinics, health-care providers, employers, and employee representatives to help injured workers get high-quality care and return to a job they are capable of doing as quickly as possible."²¹

One COHE project, in Renton, resulted in much higher instances of injured employees returning to the same employer. Injured employees were back at work within six months and reported being well satisfied with the care they received.²²

The Department has indicated its plans to expand the number of COHE locations by 2013 in order to curtail costs and improve the claims management process.

¹⁸ Tim Talley "Group divided on workers' comp privatization," [thestreet.com](http://www.thestreet.com/story/10622909/group-divided-on-workers-comp-privatization.html), November 5, 2009. Available at www.thestreet.com/story/10622909/group-divided-on-workers-comp-privatization.html

¹⁹ "Colorado: State's largest comp insurer says no changes needed to its structure," Risk and Insurance Online, October 12, 2009, at www.riskandinsurance.com/printstory.jsp?storyId=269600439

²⁰ "Workers' Compensation 2006," WashACE Competitiveness Brief, September 20, 2006.

²¹ "2008 Annual Report for the Washington State Fund," Department of Labor and Industries, pg. 13.

²² "Centers of Occupational Health & Education: Summary Findings," Occupational Health Services, Washington State Department of Labor & Industries, December 2007. Available at: www.lni.wa.gov/ClaimsIns/Files/Providers/ohs/CoheSummaryFindings1207.pdf

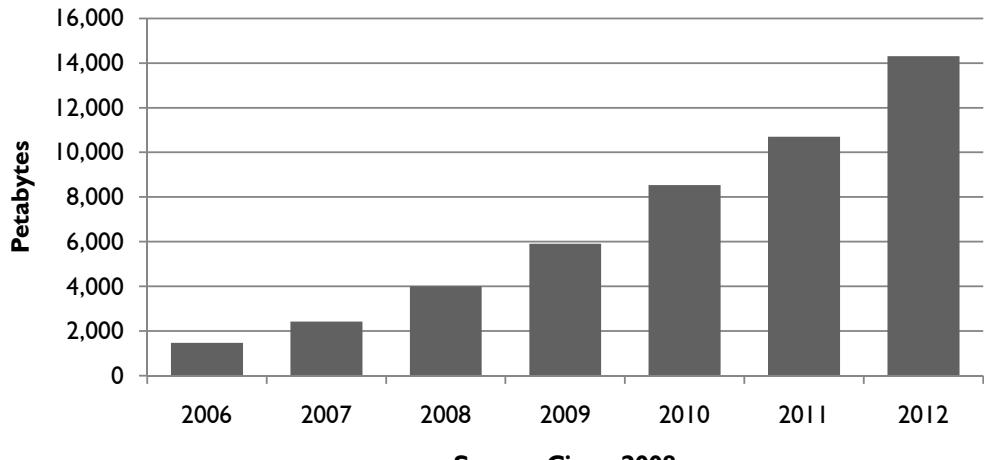
TECHNOLOGY ISSUES

Top Three Recommendations:

1. Free-market approach to Net Neutrality issue
2. More small business input to FCC regulation of the Internet
3. Amnesty for small businesses on the new digital goods tax

Background

North American IP Traffic & Forecast 2006-2012



Technology has transformed not only society but how our entire economy functions. Just a decade ago technologies such as Blackberries, iPhones, YouTube and Google were either in their infancy or non-existent.

With technological advances come coterminous regulatory changes, both on the state and national level. The two issues that small business owners focused on during this breakout session were the proposed Net Neutrality regulations the Federal Communications Commission may adopt in the Spring of 2010 and the recently-passed digital goods taxation law enacted by the Washington legislature in early 2009.

Both issues impact the way business is done over global networks and have real monetary and compliance cost implications for the business community, as well as for consumers.

Net Neutrality Issue

Before consumers can purchase goods online or use online services, they require access to the Internet (aka Network). And consumers' demand for all things related to the Internet has risen dramatically over the last decade, putting a tremendous amount of strain on the Internet Service Providers' (ISP) network capacity. Some estimates put total bandwidth per capita in America at 28 kilobits in 2000, rising to three megabits in 2009 – an 8,300% increase.²³

²³ Bret T. Swanson, "Net Neutrality's Impact on Internet Innovation," Hearing Testimony before New York City Council's Committee on Technology in Government, available at <http://entropy-economics.com/wp-content/uploads/2009/11/ee-tech-research-nycc-nn-testimony-112009pdf.pdf>

Cisco Systems estimates that annual global Internet traffic will exceed half a zettabyte²⁴ in four years and that the Internet in 2012 will be 75 times larger than it was in 2002, or the information equivalent of seven billion DVDs each month. Cisco also estimates that the most robust growth in Internet traffic will come in the form of video services and mobile devices. Video will account for 90% of consumer traffic by 2012, and mobile data will double each year for the next several years.²⁵

Expanding the networks that connect consumers to the Internet is expensive. Whether mobile or wired, keeping up with demand costs billions of dollars every year for all ISPs. Because demand is currently outstripping supply, network providers have to look at managing their own networks in an efficient manner that serves the most consumers with the highest speed possible – access to unlimited bandwidth for all consumers is not possible.

However, the Federal Communications Commission (FCC) has issued a Notice of Proposed Rulemaking to codify six principles on Net Neutrality in order, regulators say, to maintain an open Internet.²⁶

Small business owners showed grave concern about further government regulation of the Internet, as the FCC has previously applied a light regulatory touch to e-commerce and to the Internet as a whole. Since the Internet became a viable commercial and social product, it has seen tremendous growth without strict FCC scrutiny. Though several of the Net Neutrality proposals sound innocuous, small business owners voted to recommend the FCC not impose further regulation on Internet access for the time being.

Small business owners may not be taking full advantage of services that require high capacity broadband connections, but the owners/operators of small firms understand that a greater regulatory barrier to technological innovation costs time, money and jobs. This is truer for small businesses than for large companies.

I. Free-market approach to Net Neutrality issue

Small business owners thought more government regulation of the Internet would actually curtail the explosive growth we have witnessed during the last decade and a half. Managing networks, while sounding simplistic, is little more than supply and demand economics. As demand increases, ISPs will look for ways to meet that demand. Some among the technology community reject the notion that an Internet subscription can be capped or subjected to peak usage metering, but these network management principles work in managing other types of congestion, such as commute time reduction.²⁷

Connected Nation estimated a \$134 billion economic benefit from enhanced broadband rollout, with over \$3 billion in benefits to Washington state alone. The same report also estimated that tens of thousands of jobs could be created in the state because of broadband expansion.²⁸

²⁴ 1 zettabyte equals 1,000 exabytes; 1 exabyte equals 1,000 petabytes; 1 petabyte equals 1,000 terabytes; 1 terabyte equals 1,000 gigabytes; or, more simply, 1 zettabyte = 10^{21} bytes.

²⁵ "Approaching the Zettabyte Era," White Paper, Cisco Systems, June 16, 2008, at www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white_paper_c11-481374.pdf

²⁶ FCC Notice of Proposed Rulemaking from October 22nd meeting: www.hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-93A1.pdf

²⁷ For more information on techniques for managing congestion, see "Avoiding Seattle's Congested Future," by Sam Staley, opinion-editorial, April 2009, at www.washingtonpolicy.org/Centers/transportation/opinioneditorial/avoid_seattles_congested_future.html

²⁸ "The Economic Impact of Stimulating Broadband Nationally," Connected Nation, February 21, 2008, at connectednation.org/_documents/Connected_Nation_EIS_Study_Full_Report_02212008.pdf

The Obama Administration has made universal broadband a central goal of its technology policy agenda. Supporters of more government regulation of the Internet often claim that the only way to guarantee universal adoption is through mandatory policies such as Net Neutrality. However, the Pew Internet & American Life Project points out that broadband adoption is now at 63% of adult Americans and that many of those who do not have a broadband connection at home say they are not interested in connecting.²⁹

In Seattle, the numbers are even higher. As of 2009, 74% of households in Seattle have broadband connections. In 2000, only 18% of households had high-speed Internet access.³⁰

It is clear that the growth of both demand for Internet services and broadband capacity is far from subsiding. It is also evident that no government mandate brought about this growth. ISPs should take care to not restrict consumers' access to legal content (which has yet to happen in the United States), but other than that the FCC should retain its mostly "hands off" regulatory approach to the Internet.

2. More small business input on Net Neutrality

Small business owners would like to petition the federal agency in order to share their concerns. The FCC will accept comments on the proposed rules through mid-January 2010 and the FCC will hold public workshops on key issues in the first half of 2010. The agency will also coordinate public outreach through www.openinternet.org where Commissioners will regularly blog about this issue and the agency is also looking into using social media platforms as another way to engage with the public.

Small business owners want to make sure they are not left out of the discussion as policymakers in Washington, D.C. decide whether and how the Internet should be regulated.

3. Limited amnesty for small businesses with the new digital goods tax law

In 2009, the state legislature enacted ESHB 2075, which clarifies the definition of a "digital personal good," and sets some basic rules for taxation of intangible personal products. An intangible electronic product means a digital good or service such as a digital book, digital audio and video files, ringtones, etc.

This was a move to bring Washington state in line with the Streamlined Sales and Use Tax Agreement – a cooperative agreement among 22 states, local governments and businesses, to simplify sales and use tax collection and administration by retailers and states. This was the major legislation that also changed Washington's sales and use tax to a destination-based system. Previously, taxes imposed on the shipment of goods depended upon where the seller's business is located, not on where the buyer made the purchase.

Under the new law, sales and use tax is due on digital products ranging from music downloads to streaming video. Previously, downloaded music (e.g. iTunes) was subject to sales tax, but now all digital music is taxable, regardless if it is downloaded, streamed, etc.

²⁹ "Home Broadband Adoption 2009," Pew Internet & American Life Project, June 2009, pgs. 3, 7-8, at www.pewinternet.org/~media//Files/Reports/2009/Home-Broadband-Adoption-2009.pdf

³⁰ "2009 Resident Survey Report: Information Technology Access and Adoption in Seattle," Community Technology Program, Department of Information Technology, pg. 2, at www.seattle.gov/tech/indicators/docs/2009_TechAccessAndAdoptionInSeattleReport.pdf

As technology and commercial activity via the Internet continues to grow at a rapid pace, it can be difficult for small businesses, with limited resources when compared to larger competitors, to comply in a timely manner. Because Washington relies so heavily on sales tax revenue, the state leans on businesses to collect the sales tax on behalf of the state from customers, and then remit the proceeds to the Department of Revenue. It may be difficult for some small businesses to adapt quickly to this new procedure. Even though it went into effect in July 2009, small business owners want limited amnesty from collecting the tax on behalf of the state.

One way this could be accomplished is through a credit or threshold system where small businesses are credited remitting the tax revenue up to a certain amount.

REGULATORY REFORM

Top Recommendations:

- 1. Cancel unneeded regulations after a certain amount of years**
- 2. Support better legislative oversight and accountability on major agency rule making**
- 3. Create apprenticeship programs at technical and community colleges**

Local, state and federal regulatory agencies exercise tight control over the workplace practices of Washington employers. Today, Washington small businesses and major industries face an expanding array of regulations at all levels of government.

Very small firms, that is, those with fewer than 20 employees, spend 45% more per employee than larger firms to comply with federal regulations. A firm with fewer than 20 employees might spend \$7,647 per employee to comply with federal regulations, whereas a firm with over 500 employees would spend only \$5,282 per employee.³¹

It is difficult, however, to ascertain the exact cost of all regulations to a firm or to the consumer. Many times regulations limit business opportunities and the supposed public benefits can be subjective. But enough data exists to point to a general cost of regulations. Regulations emanating from the federal government are easier to discern. State and local economic impacts of regulations are more difficult to assess.

According to the Competitive Enterprise Institute, federal regulatory compliance costs hit \$1.72 trillion in 2008, or 39% of the federal spending for that year. The group also reports that the 2008 *Federal Register* is close to breaking the 80,000 page barrier and that in 2008, federal agencies issued 3,830 final rules, a 6.5% increase from 3,595 rules in 2007. Currently, federal agencies are considering 4,004 additional regulations, 753 of them would directly affect small businesses.³²

Each regulation by itself is unlikely to break a business. However, the thousands of regulations piling one upon another causes confusion among business owners who do not have teams of personnel to handle myriad of changes.

³¹ "The Impact of Regulatory Costs on Small Firms," by Mark W. Crane, Lafayette College, Easton, Pennsylvania, 2005. Research done under contract for the United States Small Business Administration, at www.sba.gov/advo/research/rs264tot.pdf

³² Clyde Wayne Crews Jr., "Ten Thousand Commandments: 2009 Edition," Competitive Enterprise Institute, at: cei.org/cei_files/fm/active/0/Wayne%20Crews%20-%2010,000%20Commandments%202009.pdf

I. Cancel unneeded regulations after a certain amount of years

Under the current system, many state regulations last forever. Policymakers should require all agency rules and regulations to carry a sunset provision, every five years be reviewed and, if still needed, reauthorized by the legislature and/or the governor.

According to the Office of the Code Reviser, state agencies submitted over 14,000 pages of administrative rules in 2008 (latest numbers available). Since the year 2000, over 5,300 state rules were adopted, resulting in over 61,000 pages of code.³³

The proliferation of state regulations is exacerbated by regulations imposed by federal agencies. There is little to no coordination between state and federal agencies to avoid regulatory duplication or overlap. This compounds regulatory compliance costs for small businesses.

2. Support better legislative oversight and accountability on major agency rulemaking

Putting the burden of proof on state agencies by requiring clear legislative authority – by making legislators approve agency rules through the legislative process – would help stem the proliferation of agency rules, and bring transparency and accountability back to the agency rule-making process.

Two ideas taking root in other states curtailing excessive regulation include New York's Governor's Office of Regulatory Reform (GORR) and a state regulatory ombudsman (which several states have adopted). In New York, GORR is instructed to work with state agencies to reduce the number and complexity of state regulations. GORR's objective is to make New York more attractive to businesses, and it has been credited with helping to create thousands of new jobs.³⁴

A small business ombudsman would be a state official tasked with representing a group of people, in this case small businesses, by receiving their complaints and investigating on their behalf. The idea is based on the Small Business Administration's Office of the National Ombudsman. Alaska, Arizona, Hawaii, Oregon, Ohio, South Carolina, Iowa, Wisconsin and Nebraska all have small business ombudsmen.³⁵

The government of British Columbia implemented a regulatory reform program earlier this decade and succeeded in eliminating more than 70,000 regulations, with the expressed goal of cutting regulations by one-third within three years.³⁶

It is important for policymakers to recognize that small business owners are not asking for a repeal of agency rules or legislation that would jeopardize public safety or the well being of themselves, their employees or customers. The sheer number of agency rules confounds many small business owners. Keeping up with changes, additions and subtractions to the state's codes is tough to do while also running a business.

³³ "Agency Rule-Making Activity," Washington State Register, www.leg.wa.gov/CodeReviser/Documents/rulactiv.pdf (accessed December 8, 2009)

³⁴ For more information on the Governor's Office of Regulatory Reform, see: www.gorr.state.ny.us/

³⁵ More information on the states' ombudsmen can be found at:

www.business.gov/business-law/contacts/ombudsman.html

³⁶ www.llbc.leg.bc.ca/public/PubDocs/bcdocs/365824/sb_newerabrochure.pdf

3. Put apprenticeship programs in technical and community colleges

An apprentice is an individual who is employed to learn a skilled occupation and is registered with a sponsor in an approved program. Apprenticeship programs are regulated by the state and the Washington State Apprenticeship and Training Council, which are overseen by the Department of Labor and Industries.³⁷

Small business owners recommend moving the Washington State Apprenticeship and Training Council away from the Department of Labor and Industries and instead placing it under the State Board for Community and Technical Colleges, because apprenticeship is a combination of both classroom education and on-the-job work experience. Small business owners feel the community and technical college system would greatly expand training opportunities for workers, especially during this critically important economic recovery period.

Since classroom education is a core part of any apprenticeship program, housing the administration of the Washington State Apprenticeship and Training Council at the State Board for Community and Technical Colleges would facilitate more worker training opportunities. Many community and technical colleges already have some experience with providing classroom training for apprenticeship programs. This recommendation builds on and expands such opportunities to train workers across Washington. This recommendation would also increase efficiencies within state government, by avoiding duplicate administration in two different agencies to oversee the classroom training for apprenticeship programs in this state.

ENVIRONMENTAL REGULATIONS

Top Recommendations:

- 1. Do not add or expand state regulations to existing or new federal regulations**
- 2. Encourage market-based solutions for stormwater controls and other regulations**
- 3. Simplify environmental regulations, make them more objective and apply cost/benefit analysis**

Environmental regulations have the capacity to affect many more industries than would traditionally be thought of as environmental businesses. Industries affected by environmental regulations are as disparate as dry cleaning to auto repair to construction and many more.

It is important to note that small business owners are not interested in harming the environment. Instead, business owners are uniformly interested in a clean environment, in enhancing the efficiency of the regulatory system, reducing regulatory overlap and improving customer service. By doing so, environmental protection in Washington will be strengthened, allowing agencies to direct their resources more efficiently.

I. Do not add or expand state regulations to existing or new federal regulations

Most existing environmental regulations are a direct result of the broad powers lawmakers gave state agencies in the 1971 State Environmental Policy Act (SEPA) and the Clean Air Act, the Clean Water Act, and many other

³⁷ WAC 296-05-003

federal environmental regulations. Today, a complex system of local, state and federal regulations combine to influence almost every type of business activity. State policy relies heavily on command-and-control regulation and imposes an increasingly expensive burden on local residents and business owners.

Regulations going above and beyond federal guidelines are often seen as a state tailoring legislation to meet a specific need. But too often, going above and beyond federal mandates only increases the gradual infringement of government regulations – regulations that often do more harm than good.

Federal regulations were designed to guarantee a level of safety acceptable to society at large. There is an unwritten consensus among state officials that the federal laws were created to be the bare minimum – more of a starting point. In reality, the federal regulations, with a few exceptions, are sufficient to promote public safety and protect the environment. Over the years, however, Washington policymakers have added dozens of state-specific regulations that expand the reach of environmental rules. The downside has been myriad overlapping regulations and agency jurisdictional conflict – federal, state or local – which puts the burden on the business community to wade through the conflicts.

2. Encourage market-based solutions to the stormwater issue and other regulations

Stormwater is the water that runs off surfaces such as rooftops, paved streets, highways, and parking lots. It can also come from hard grassy surfaces like lawns, play fields, and from graveled roads and parking lots. In some areas of Washington, gravelly soils allow rapid infiltration of stormwater. Untreated stormwater discharging into the ground could contaminate aquifers that are used for drinking water.

Untreated stormwater is unsafe for humans or sea life. The Department of Ecology (DOE) handles stormwater discharge permits for the federal Environmental Protection Agency (EPA). Recent EPA rules, as administered through DOE require operators of municipal storm sewer systems to develop and implement a stormwater management program that (1) reduces the discharge of pollutants to the “maximum extent practicable,” (2) protects water quality, and (3) satisfies appropriate requirements of the Clean Water Act.

Small business owners are mostly worried about the way issues such as this are ignored by the legislature and enforced by state agencies. The issue of stormwater is symptomatic of a larger issue – elected officials deferring environmental problems to unelected bureaucrats in state agencies, instead of allowing for more innovation and technological improvements in how stormwater permits are handled.

3. Simplify environmental regulations by making them more objective and applying a cost/benefit analysis

Protecting the environment is important to our way of life in Washington state. The debate ranges around what are the best policies to ensure environmental health while encouraging commercial activity. Can both the environment and the economy flourish at the same time?

Often, environmental regulations become skewed towards political agendas instead of actually helping the environment.³⁸ Some of these concerns

³⁸ For more analysis on this point, see “A Pop(u)lar Eco-Fad,” available at: [http://www.washingtonpolicy.org/Centers/environment/opinioneditorial/Pop\(u\)lar_Eco_Fad.html](http://www.washingtonpolicy.org/Centers/environment/opinioneditorial/Pop(u)lar_Eco_Fad.html) and “Car-Free Days are Seattle’s latest eco-fad, but are there any real benefits?” available at: <http://www.washingtonpolicy.org/Centers/environment/envwatch/Sept08EnvWatch.html>

can be mitigated through more efficient use of cost/benefit analyses – not just in assessing the financial cost of compliance, but also comparing the desired outcomes with actual outcomes.

As Christopher DeMuth and Douglas Ginsberg point out, a cost/benefit analysis is

...a device for gauging public interventions in a world that is governed mainly by the decisions of individuals and markets, and where the political process generates profuse demands for intervention that vary greatly in their merits and cannot all be accommodated in any event.³⁹

Essentially, applying a cost benefit analysis to environmental regulation is a must, but the results must be focused on achieving an actual environmental or public good. Otherwise the regulation is subject to manipulation by politicians thereby running the risk of helping neither the public nor the environment.

UNEMPLOYMENT INSURANCE

Top Recommendations:

- 1. Award benefits based upon statutory authority (eliminate the “liberally construed” clause)**
- 2. Freeze the voluntary quits option**
- 3. Keep UI benefits the same over the next calendar year (2010)**

Just like every other state, Washington's unemployment rate jumped very high and very quickly beginning in the later part of 2008. As of November 2009, the unemployment rate for Washington was 9.2%, slightly lower than the recession high of 9.4% in June 2009. This has put tremendous strain on the unemployment insurance system.

According to the Employment Security Department (ESD), the unemployment insurance trust fund hit a high of \$4.1 billion in November 2008, or 21.3 months of benefits.⁴⁰ As of December 2009, the trust fund had decreased to \$2.6 billion or about 13 months of benefits.⁴¹ The state maintains no less than 12 months of benefits on hand as a contingency reserve.

Washington's unemployment insurance system imposes the second-highest per employee cost in the nation. While the tax *rate* is not higher than most states, businesses in Washington must pay that rate on the first \$36,800 of salary for each employee. In contrast, businesses in most other states only pay unemployment taxes on the first \$7,000 to \$10,000 of salary, resulting in a much lower tax burden.

A primary cost-driver of Washington's state-run system is the high level of benefits officials pay out to unemployed workers. The maximum unemployment benefit (not including the state and federal temporary stimulus packages) is a generous \$541 a week, close to the highest in the nation. Washington's average weekly benefit payout is \$366, almost 20% higher than the nationwide average of \$306.

³⁹ Christopher C. DeMuth and Douglas H. Ginsberg, “Rationalism in Regulation,” American Enterprise Institute Center for Regulatory and Market Studies, December 4, 2009, pg. 10. Available at www.aei.org/paper/100064.

⁴⁰ “Economic Update May 2009: Quarterly Snapshot of Washington State’s Unemployment Insurance Trust Fund,” Employment Security Department. Available at: <http://www.esd.wa.gov/news-and-information/legresources/uiac/archive/qtrly-snapshot-ui-trust-fund-june-09.pdf>

⁴¹ Slide 8, “Unemployment Trust Fund,” Employment Security Department presentation before the House Commerce & Labor Committee, January 13, 2010. Available at: washingtonpolicy.org/Centers/smallbusiness/PDF/ESD_Presentation_Commerce_and_Labor.pdf

Policymakers also make it easy for workers to receive tax-funded unemployment benefits. A worker doesn't even have to be unemployed to receive payments. Among the eleven reasons a person can use to get state unemployment benefits are, "to accept other work," a pay reduction of 25%, or a reduction in work hours of 25%.

In 2008, the legislature expanded the unemployment insurance program by making workers eligible for UI benefits if they chose to quit their jobs voluntarily in order to join an apprenticeship program. In 2009, the legislature added employees who left their job because they were victims of domestic violence or stalking.

I. Eliminate liberal construction of cases

For a number of years, Washington's unemployment insurance (UI) program has been "liberally construed" when it came to the agency officials determination of eligibility for benefits. In other words, if there was any uncertainty about a worker's benefit eligibility, the agency should side with the worker and against the employer when awarding benefits.

The language in RCW 50.01.010 says, "The legislature, therefore, declares that in its considered judgment the public good, and the general welfare of the citizens of this state require the enactment of this measure, under the police powers of the state, for the compulsory setting aside of unemployment reserves to be used for the benefit of persons unemployed through no fault of their own, **and that this title shall be liberally construed for the purpose of reducing involuntary unemployment and the suffering caused thereby to the minimum.**" [Emphasis added]

In 2003, the legislature passed SB 6097, which removed the emphasized part of RCW 50.01.010 – negating the liberal construction portion of the law. This forced the agency to end its practice of awarding benefits to workers whose eligibility may have been in question.

However, in 2005, the legislature passed HB 2255 which re-instituted the "liberal construction" clause from pre-2003's legislation.

Small business owners felt that the language of the statute should be specific so that a worker is not given an undue advantage in collecting benefits, thereby artificially driving up the cost to the state's businesses. An employee is either eligible under the statute, including the eleven "voluntary quits" provisions, or he is not.

2. Freeze the "good cause" voluntary quits option

In certain cases an employee who quits voluntarily can still receive UI benefits. The legislature expanded the "good cause" list to eleven during the 2009 Session with the addition of victims of domestic violence or stalking. The previous year the legislature added those who quit a job voluntarily to join an apprenticeship program to the list of eligible beneficiaries.

Some of the other "good causes" include leaving to accept other work; illness or disability of the individual or someone in the individual's immediate family; change in the work site that caused increased distance or difficulty of travel; deterioration of work site safety; the work violates an individual's religious convictions or sincere moral beliefs, and more.

The 2003 UI reforms (SB 6097) included changing the "good cause" voluntary quits provision so that there were only ten specific reasons for granting

benefits to a worker who quit voluntarily. Previously, the list was thought of more as a general guidance for the department.

However, a Washington State Supreme Court case in 2008 reversed this trend. In *Spain v. Employment Security Department*, the Court ruled that the way the legislature had written SB 6097 was ambiguous and that the listed reasons were not exhaustive; therefore, ESD should go back to using the list as a guideline. This meant that a worker who voluntarily left his job could appeal to become eligible under the “good cause” list even if his specific reason is not among the legislatively approved reasons.⁴²

Small business owners are worried about expanding the “good cause” provisions or the department’s loose interpretation of what constitutes a “good cause” because this drives up the cost amongst all business owners. The cost of paying benefits to a former employee is a socialized cost, meaning it is a tax liability to all businesses and their customers.

3. Keep UI benefits the same over the next calendar year (2010)

When the legislature passed HB 1906 in 2009, it increased the minimum weekly benefit amount from \$129 per week to \$155 per week. In addition, the legislature added a temporary benefit of \$45 to an individual’s weekly amount. The \$45 temporary increase was in place until January 2, 2010.

Small business owners are concerned that the legislature will again increase benefits to unemployed workers because it will mean higher taxes for all businesses. The initial cost forecast for HB 1906 was approximately \$111 million for the 2009-2011 biennium. Using the November 2009 Economic and Revenue Forecast Council numbers, ESD revised that estimate upwards to \$247 million (a 122.5% increase).⁴³

The fiscal note missed its forecast because it had assumed an unemployment rate of 7.5%; a rate which Washington state surpassed in January 2009. Washington has hovered between 8.9% and 9.3% between March and November 2009; therefore, there were far more UI claims than officials forecast.⁴⁴ The HB 1906 fiscal note assumed 2.3 million weeks of benefits paid between May and December 2009. As of mid-December 2009, the number of weeks paid had already exceeded 6 million.⁴⁵

Over one quarter of laid off workers collecting unemployment insurance are collecting the maximum benefit.⁴⁶ This means that the more lay-offs there are due to the recession, the heavier the financial hit to the trust fund. Conversely, only about 8% of UI beneficiaries collect the weekly benefit minimum.⁴⁷

In early December 2009, ESD announced that the average UI tax rate would increase approximately 54% in 2010. The Department took in just over \$1 billion in taxes, but paid out about \$4 billion in benefits, obviously an

⁴² “Make Unemployment Insurance Work,” WashACE Competitiveness Brief, CB 08-08 September 22, 2008, at www.washace.com/docs/Pdfs/UI_Brief_Final.pdf

⁴³ Electronic correspondence to author on January 8, 2010. Available online at: washingtonpolicy.org/Centers/smallbusiness/PDF/DR_467_1906_cost_estimate_10810-2.pdf

⁴⁴ ESHB Fiscal Note 1906, at <https://fortress.wa.gov/ofm/fnspublic/legsearch.asp?BillNumber=1906&SessionNumber=61>

⁴⁵ “Weeks of Unemployment Compensation Paid, all Entitlements, by Claim Week, 2006-Present,” Employment Security Department, at <http://www.esd.wa.gov/newsandinformation/media/uidata/currentuistatisticalinformation/wkly-weeks-claimed-05-08-table.pdf#zoom=100>

⁴⁶ “Claimant Expenditure Survey; Fiscal Year 2007,” Unemployment Insurance Division, Office of Research & Analysis, Employment Security Department, at: <http://www.esd.wa.gov/newsandinformation/media/uidata/uipublishedreports/claimant-expenditure-survey-2007.pdf#zoom=100>

⁴⁷ ESHB Fiscal Note 1906.

unsustainable practice, hence the planned tax increase for 2010. According to the Department as well, projected contributions (or tax collections) will continue to increase through 2012 – ending up at over double 2009’s rates.⁴⁸

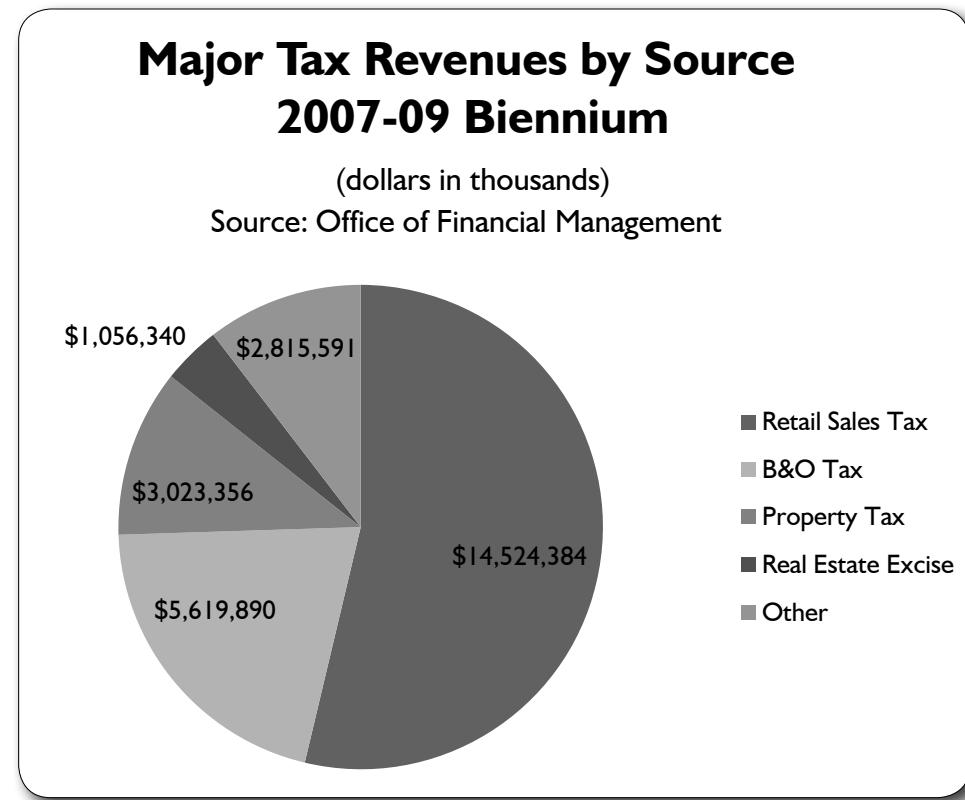
Small business owners want policymakers to forgo increasing benefits during 2010 in order to avoid another round of sharp tax increases.

STATE TAX ISSUES

Top Recommendations:

1. **Level the playing field with respect to gaming, cigarettes, etc.**
2. **Do not increase taxes**
3. **Continue with thorough performance audits of state agencies**

Background



The people of Washington pay over 50 different kinds of taxes at the state and local level.⁴⁹ The largest single revenue source for state and local government is the general sales and use tax, representing about 55% of all taxes. The next largest revenue source is the Business and Occupation tax (B&O).

The proper function of taxation is to raise money for core functions of government, not to direct the behavior of its citizens. This is true whether government is big or small, and this is true for lawmakers at all levels of government. Many lawmakers think of the tax code as a way to penalize “bad” behaviors and reward “good” ones. They have sought incessantly to guide, micromanage and steer the economy by manipulating the tax laws.

⁴⁸ “Slide 13 – Unemployment Taxes,” Employment Security Department presentation before the House Commerce & Labor Committee, January 13, 2010. Available at: washingtonpolicy.org/Centers/smallbusiness/PDF/ESD_Presentation_Commerce_and_Labor.pdf

⁴⁹ “Tax Reference Manual, Information on State and Local Taxes in Washington State,” Revenue Research Report, Department of Revenue, Olympia, January 2007, p. 1, at dor.wa.gov/Content/AboutUs/StatisticsAndReports/2007/Tax_Reference_2007/default.aspx

Taxation will always impose some damage on an economy's performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare or other extraneous purposes. A simple and fair tax system is an ideal way to advance Washington's economic interests and promote prosperity for its residents.

Maintaining a low tax burden on the business community has several benefits. A tax system that lets small business owners keep most of what they earn results in faster economic growth. It also creates greater and faster wealth creation, which business owners can use to expand their workforce or business. A fair tax system also ends the micromanagement of the economy by policymakers, who are often tempted to gift unwarranted subsidies to businesses or industries that are otherwise unable to succeed in the open market.

I. Level the playing field with respect to gaming and other tribal businesses

For decades, tribal businesses (including casinos and hotels) have benefited from a system of rules and regulations that gives their owners a significant competitive advantage over non-tribal businesses. Whether in the form of exemptions from unemployment insurance, business and occupation taxes, or workers' compensation taxes, tribal businesses operate in a reduced regulatory environment. Nowhere is this truer than in the gaming industry.

There are 29 federally recognized Indian tribes in Washington. These tribes operate 28 casinos, which together generated approximately \$1.571 billion in gross revenue in 2009.⁵⁰ This represents a 478% jump in gross receipts for tribal gaming companies since the year 2000 (\$272 million that year).⁵¹

In Washington, state and local governments are specifically prohibited by federal law from taxing any aspect of tribal gaming, whether it is a business and occupation tax on operations, or sales and use taxes for equipment. Also, no taxes are allowed on tribal gaming itself.

Some tribal businesses make limited impact mitigation payments to local governments to help cover the cost of community services. Unlike regular taxes paid by other citizens, however, these payments are voluntary, and the amount is negotiated between the tribal business owners and local governments. Tribal business owners only make revenue-sharing and impact mitigation payments after their businesses have made a clear profit. In contrast, non-tribal business owners must pay the state B&O tax whether they make a profit or not.

Policymakers should set up a review of the relationships between the state and tribal businesses in areas of commerce where the tribes compete with non-tribal businesses. In several areas, tribal businesses are benefiting from a clear and artificial competitive advantage over non-tribal businesses. An object assessment is needed to determine whether the special tax and regulatory treatment granted to tribal businesses is exceeding its intended purpose.

2. Do not increase taxes

Policymakers are again facing a multi-billion dollar budget deficit and many are looking for ways to increase revenue (e.g. taxes) collected by the state. Some of these proposals include changing the state constitution in order to implement a state income tax, an income tax on higher-end incomes, increasing

⁵⁰ "Fiscal Year Net Receipts Comparison," Washington State Gambling Commission, at www.wsgc.wa.gov/docs/stats/pie_charts.pdf

⁵¹ Ibid.

taxes on specific items such as candy, gum or other currently exempted goods, increasing the state sales tax from 6.5% to 7.5%, and more.

Since taxes lower the economic welfare of citizens, policymakers should minimize the economic and social problems that taxation imposes. Citizens then directly gain the benefits of a low tax burden. Washingtonians require and expect basic government services, and taxes must be collected to pay for these services. Government revenue should be limited to real public needs, so the tax system itself does not become one of the major problems of business. A fair and efficient tax system shows respect for the citizens and businesses of our state.

According to the U.S. Census Bureau, Washington ranks 18th in state and local tax burdens (1st being highest) and the business community paid almost \$15 billion in taxes to state and local governments in 2008.⁵²

Government spending grew from \$22 billion in the 1999-2001 biennium to \$31.3 billion in the 2009-2011 biennium. That represents over 40% growth in government spending in the last decade.⁵³ Small business owners are concerned that this growth rate is unsustainable – and the large budget deficits the last two years have proved the small business owners' prescience.

Policymakers should find ways to curtail government spending in order to handle the budget deficit and not raise taxes on a business community that is already hurting because of the national economic downturn.

3. Continue with thorough audits of state agencies

In 2005, state voters approved Initiative 900, which granted the State Auditor performance audit authority. Performance audits look at government programs to see whether state agencies are using public money efficiently. The audits root out the causes of waste and measure a program's actual performance against its goals and objectives.

The State Auditor has conducted 23 audits as of December 2009, “identifying billions of dollars in unnecessary spending, potential cost savings and economic benefits and recommending numerous ways to improve state and local government operations.”⁵⁴

It is clear that small business owners and voters of Washington state want performance audits of state agencies because of the vast improvements they can bring. The key is to encourage policymakers to actually implement the cost-saving recommendations provided by the Auditor’s office.

COMPETITIVENESS ISSUES

Top Recommendations:

- 1. Reduce overall tax burden on businesses**
- 2. Adopt an hourly wage rate for low-skill or new workers**
- 3. Do not enact the worker privacy act/employer gag rule**

Just how competitive or business friendly Washington state is has been debated for a long time. Various national rankings place Washington’s business climate from very good to poor and everywhere in between. There is universal

⁵² “Tables 9 and 10,” 2010 Competitiveness Redbook, Association of Washington Business and WashACE, September 2009.

⁵³ Information compiled from www.fiscal.wa.gov (December 15, 2009).

⁵⁴ “State Government Performance Review: Opportunities for Washington,” Washington State Auditor’s Office, Report No. 1002726, December 2009.

agreement that making Washington state competitive for businesses, both large and small, is of the utmost importance. But what does it mean to have a competitive business environment, one capable of attracting out-of-state business to relocate, or that encourages aspiring entrepreneurs to make the plunge?

I. Reduce overall tax burden on businesses

Businesses do not pay taxes. People pay taxes. Therefore policymakers should recognize the link between high tax rates on businesses and its effects on citizens – the employees of the business and the consumers. A high tax rate has the potential to drive businesses away both through disincentives to hire and through artificially high prices.

According to the Council on State Taxation and the Puget Sound Regional Council, Washington businesses pay 51.3% of state and local taxes in 2008.⁵⁵ The 2008 nationwide average for the business tax burden is 44.1%. The tax burden is felt most heavily in the sales tax category, followed by property taxes, excise and gross receipts, unemployment insurance and finally license and other taxes.

With the state facing a \$2.6 billion budget deficit for the rest of the 2009-2011 biennium, it is unlikely that any reduction in taxes on businesses will take place. State officials are also predicting another \$2.8 billion budget deficit for the 2011-13 biennium.⁵⁶ But policymakers should recognize that lower taxes spur economic growth, which in turn increases the likelihood of firms ramping up hiring – a crucial component to righting the economy and refilling government coffers.

A recent study by Harvard economists Alberto Alesina and Silvia Ardagna points out that

tax cuts are more expansionary than [government] spending increases in the cases of a fiscal stimulus... For fiscal adjustments we show that spending cuts are much more effective than tax increases in stabilizing the debt and avoiding economic downturns. In fact, we uncover several episodes in which spending cuts adopted to reduce deficits have been associated with economic expansions rather than recessions.⁵⁷

2. Adopt an hourly wage rate for low-skill or new workers

For years Washington small businesses have asked for relief from the state's high minimum wage regulations. Since voters passed Initiative 688 in 1998, the Consumer Price Index (CPI), not elected officials, has set the minimum wage. In 1999, the minimum wage was \$5.70 per hour; in 2009 the wage was up to \$8.55 per hour. These automatic increases mean Washington routinely has the highest minimum wage in the nation.

The artificially high minimum wage may be appropriate for some workers, but for younger employees or those with no work experience, the high wage is actually a severe detriment. *The Wall Street Journal* reported on the effect of a high minimum wage on inexperienced or young workers: On a national scale,

⁵⁵ "Total state and local business taxes: 50 estimates for fiscal year 2008," Ernst & Young, January 2009.

⁵⁶ "Gregoire laments state budget," by Brad Shannon, The Olympian, December 10, 2009, at: www.theolympian.com/legislature/story/1065738.html

⁵⁷ Alberto Alesina and Silvia Ardagna, "Large changes in fiscal policy: taxes versus spending," October 2009, at: [economics.harvard.edu/faculty/alesina/files/Large%2Bchanges%2bin%2Bfiscal%2Bpolicy_October_2009.pdf](http://economics.harvard.edu/faculty/alesina/files/Large%2Bchanges%2Bin%2Bfiscal%2Bpolicy_October_2009.pdf)

unemployment of people ages 16 to 19 was a seasonally adjusted 23.8% in July 2009, after hitting a quarter-century high of 24% in June.⁵⁸

The minority community is also hit disproportionately hard. The unemployment rate for African-American teens was reported at 35.7% whereas the white teenage unemployment rate was only 22.2%.⁵⁹

On one level, policymakers understand the need for an entry wage for young workers. Currently, Washington law allows 14- and 15-year-olds to be paid 85% of the minimum wage. But there is no break for employers past that point. Small business owners were not specific on how they would like to arrange a pay structure for inexperienced or young workers. Some anecdotal examples include freezing the current minimum wage (\$8.55) for inexperienced and new workers for the next several years, even if the general minimum wage continues to increase. Another is extending the young worker wage to 16- and 17-year-olds.

The Department of Labor and Industries, the state agency which administers the minimum wage, announced that 2010 would bring no increase in the minimum wage – the first time that has happened since 1998. This is due, however, to the fact that the CPI actually decreased in 2009, not because legislators or state officials wanted to increase job opportunities for young people.⁶⁰

3. Do not enact the worker privacy act/employer gag rule

In 2009, policymakers introduced legislation that would prohibit an employer from holding mandatory employee meetings to convey its views on religious and political issues – including union organizing. While the legislation does not bar employers from holding these meetings or engaging in such communications, it stipulates that attendance by employees must be strictly voluntary. And the employer can take no action against the employee for not attending the meeting.

Currently, federal law does not prohibit mandatory meetings. And it does not bar employers from imposing discipline on employees who refuse to participate in a work-related meeting where the employer is opposing unionization. The National Relations Labor Act (NLRA) recognizes employer free speech rights, as long as the speech is not violent or threatening.

During the summer of 2009 Oregon lawmakers passed legislation similar to that proposed in Washington. However, the business community has already taken the legislation to court based on the bill infringing on the employers' right to talk to employees.

In Washington, however, the state Attorney General issued an opinion on this matter stating,

First, the [Washington state] bill proposes a state prohibition and sanction for employer actions that arguably are already prohibited by the NLRA in some circumstances. Second, the provisions of SSB 5446 could be applied to limit the type of employer speech regarding union organization that Congress intended to be controlled by the free play of economic forces and reserved for market freedom.⁶¹

⁵⁸ "Unemployment Among Teenagers Remains Stubbornly High," by Erica Alini, *The Wall Street Journal*, August 10, 2009, available at: <http://online.wsj.com/article/SB124985997530518051.html>

⁵⁹ Ibid.

⁶⁰ Colorado's minimum wage will actually decrease in 2010. Similar to Washington, they have a CPI escalator clause in their minimum wage law. However, Colorado's law also stipulates that the wage can decrease when the CPI does too. Washington's law does not have that clause, so it will remain static.

⁶¹ "AGO 2009 No. 3," Office of the State Attorney General, at atg.wa.gov/opinion.aspx?section=archive&id=23460

One of the chief concerns with this policy is that small business owners fear the high costs of litigation and penalties they would face if the “worker privacy act” becomes law. The bill can equally be described as “the employer gag rule.” Currently, under the NLRA an employer who pressures employees is subject to “make whole” and “cease and desist” sanctions. Those penalties could become far more harsh with the “worker privacy act” and would likely ban small business owners from holding mandatory work-related meetings. The result would be silencing the employer free speech rights.

Conclusion

It remains to be seen if small businesses in Washington will once again lead the economy towards recovery. History shows that very small firms, those with fewer than 5 employees, account for twenty percent of jobs accounted for by business startups.⁶² If creating jobs is the number one priority for policymakers in 2010, helping the small business community is the best place to start.

Policymakers have a duty to act on behalf of the small business community, its workers and their families. Too often, policymakers act without considering or measuring the impact of their decisions on the owners of mom-and-pop businesses, even though those are the very businesses that are disproportionately hampered by the regulations and taxes they impose.

It is Washington Policy Center’s intention that legislators, policymakers, state agency personnel and media use this report as a guide to how many small business owners feel about the important issues affecting their everyday lives – both personally and professionally.

Many of the 24 ideas in this report are not new, and most are hardly revolutionary. Small businesses take pride in the nose-to-the-grindstone determination that sustains them through both tough and beneficial times. Likewise, most of these recommendations are based on common-sense suggestions that, in the end, improve the economic climate for all businesses, not just smaller ones.

⁶² John Haltiwanger, et. al., “Jobs Created from Business Startups in the United States,” Ewing Marion Kauffman Foundation, January 2009.

About the Author

Carl Gipson is Director of the Center for Small Business at Washington Policy Center. He also directs WPC's technology and telecommunications policy research. He regularly writes opinion pieces, legislative memos, policy notes, and is the author of *Reviving Washington's Small Business Climate*, *24 Ways to Improve Washington's Small Business Climate*, *A Citizen's Guide to Initiative 920: The Estate Tax*, and other publications. Carl appears regularly in print and broadcast media across the state addresses chambers of commerce and other civic groups. He was a columnist for *The Olympian* in 2003 and received his bachelor's degree in political science from Western Washington University in 2001.



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