

# Agenda <sup>for</sup> Reform:

Priority Solutions for Improving  
Washington's Small Business Climate



Presented as part of Washington Policy Center's  
Small Business Project  
[www.SmallBusinessConference.com](http://www.SmallBusinessConference.com)

An  
**in-depth**  
analysis

of the results of  
the 2003 Statewide  
Small Business Conference

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# **An Agenda for Reform:**

## Priority Solutions for Improving Washington's Small Business Climate

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### **Introduction**

Most of the United States is enjoying a robust economic recovery, with job growth and productivity increases spurring record gains in economic activity. The Washington economy, while showing signs of improvement, continues to stagnate, suffering from restrictive policies adopted by local, state and federal government that create unnecessary barriers to business success. Recent statewide debate has focused on ways to attract and keep large businesses like Boeing and Microsoft.

The health of large businesses is vital to economic recovery, but small businesses are also a catalyst for job growth and revitalization. The state's small enterprises provide over 55 percent of private sector jobs, make up more than 95 percent of all businesses and are a vital part of the state's growing knowledge-based economy. It is in the best interest of state leaders to create a business climate that encourages the growth of small business and reduces barriers to their success.

To help improve prospects for small business, Washington Policy Center (WPC) launched the Small Business Project in fall 2001. In the first phase of the Project, WPC held fourteen small business roundtables in every region of the state.<sup>1</sup> We also formed an important partnership with more than sixty statewide and local business organizations. The result of our Phase One research is a study released in March 2002 entitled, "The Small Business Climate in Washington State," identifying the state's major barriers to small business success.

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<sup>1</sup> WPC held small business roundtables in Aberdeen, Bellevue, Bellingham, Everett, Olympia, Port Angeles, Seattle, Spokane, Tacoma, Tri-Cities, Yakima, Vancouver, Walla Walla and Wenatchee.

Phase two of the Project again brought the coalition of small business groups together to find solutions to those barriers faced by the small business community. In partnership with the Association of Washington Business, Independent Business Association, National Federation of Independent Business (NFIB), the Greater Seattle and Spokane Chambers of Commerce and more than 60 other statewide and regional business organizations, WPC hosted the 2003 Statewide Small Business Conference.<sup>2</sup>

The Conference was held on October 3 at the SeaTac Hilton and was attended by more than 350 small business owners from across the state. It featured eight breakout sessions moderated by the state's leading experts on each of the eight policy issues identified by small business owners as the primary barriers to their success. Those issues are:

- Workers' Compensation and Unemployment Insurance
- Employment Regulations (Ergonomics, Minimum Wage and Youth Work Rules)
- The Rising Cost of Health Insurance
- Workforce Training
- Access to Technology and Telecommunications
- Environmental Regulations
- Tax Burden
- Liability and Tort Reform

In each session, business owners were asked to provide their recommendations for how to improve Washington's small business climate. After discussing the available options, business owners in each session voted on the priority solutions they want to see implemented.

The result is a list of priority solutions, selected by Washington's small business owners and presented here in detail, for solving the major problems with the state's small business climate. The recommendations offer a clear agenda for reform – one that local and state policymakers can use to help Washington join the economic recovery now gathering momentum across the nation. With strong leadership and a renewed focus on reform, state and local policymakers can address the concerns of small business owners and reinvigorate the entrepreneurial spirit of the Washington economy.

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<sup>2</sup> For a full list of co-sponsoring and supporting organizations, see Appendix A.

## **Workers' Compensation Insurance**

In 2003, the Department of Labor and Industries, which runs the state's workers' compensation system (also known as industrial insurance), imposed an average 29 percent increase in premium rates on Washington businesses. The increase was necessary to meet the minimum for total fund reserves required by state law.<sup>3</sup> While smaller than the originally-proposed 40 percent increase, substantially higher workers' comp rates place a continually increasing burden on small businesses, particularly those in a high risk industry. In September the Department announced another 19.4 percent increase for 2004, then in December, facing strong opposition from the business community, the increase was lowered to 9.8 percent.<sup>4</sup>

In 2003 the legislature approved a bill that limited the time allowed for filing a hearing loss claim, helping to address one of the many reasons for rising costs.<sup>5</sup> Remaining problems, including slow and costly claims management and court decisions have increased the cost of claims. Small business owners at the Statewide Small Business Conference recommended a number of additional reforms that can help reduce the recent increases in premium rates.

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### **Top Small Business Recommendations**

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Devising a competitive and effective workers' compensation system is vital to restoring the health of Washington's economy. The system influences the health of Washington's business climate in two important ways. First, the workers' compensation system provides wage replacement and medical rehabilitation coverage for workers who are injured on the job.<sup>6</sup> Losing a worker to injury can have a devastating effect on the operations of a small business. Improving the system for rehabilitating injured workers so they can return to work quickly will help workers and small businesses, and improve the business climate.

Second, while it is important to allocate sufficient resources to the workers' compensation system, it is equally important that the system not be too costly for businesses to afford. For every increase in the cost of the workers' comp system, small

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<sup>3</sup> A recent study by PricewaterhouseCoopers LLC questions the need for rate increases to meet reserve fund requirements. The study, commissioned by the Building Industry Association of Washington, estimates that workers and employers have been overcharged by an estimated \$2.1 to \$3.2 billion over nine years and that existing fund reserves are more than adequate to meet the state's fiduciary requirements. The Department disputes the study. For more information, visit BIAW online at [www.biaw.com](http://www.biaw.com) or contact them at (360) 352-7800.

<sup>4</sup> Reliable cost comparisons between Washington and other states are not available. Washington uses a unique hours-worked system of rate collection, while most other states collect premiums based on payroll.

<sup>5</sup> SB 5271, signed into law on June 20, 2003, requires workers to file a claim for hearing loss within two years of their last exposure to occupational noise. Prior to the reform there was no time limit.

<sup>6</sup> For a technical explanation of the Workers' Compensation system, see, "Employer's Guide to Industrial Insurance," published by the Washington State Department of Labor and Industries, January 2003, available online at [www.lni.wa.gov](http://www.lni.wa.gov).

businesses must increase the cost of their products to make up the difference, reducing their competitiveness in the national and international market. The recommendations presented here can help reduce rates while improving coverage for Washington workers.

## **1) Improve the claims management process**

Small business owners cite improvements to the claims management process as a key way to improve both the cost and effectiveness of the industrial insurance system. Delays and confusion when a claim is filed and as it is processed extends the time a worker is away from his or her job. Ineffective follow-up and monitoring of worker claims also allows higher levels of fraud, which drives up the price of industrial insurance for all employers.<sup>7</sup> The following recommendations from small business owners offer promising opportunities for reforming claims management.

**A. Implement industry specific claims units.** Workers' compensation claims are assigned to Department claims managers as they are submitted, with little consideration of the company or industry where the claim originated. Under this system, a small business with five claims could have five separate claims managers to deal with. Implementing a program where claims managers specialize by industry and by individual company would foster improved industry knowledge and help build productive relationships between claims managers and the companies they serve.

**B. Place reasonable limits on choosing doctors to reduce fraud.** By visiting multiple doctors in search of a diagnosis that will grant them new or continued industrial insurance benefits, some workers exploit one known loophole in the workers' compensation system. Current Labor and Industries policy allows employees to essentially shop for doctors until they find one that will agree their injury is work related.<sup>8</sup>

Department policy allows a claim to be filed up to two years after the date of the injury. Small business owners feel there should be a reasonable limit placed on the number of doctors an individual can visit in their quest to receive workers' compensation benefits. By limiting workers to three doctor opinions and requiring that claims be filed within one year of the date of injury policymakers can restore effective checks and balances for the system, insuring worker health while also reducing fraud and abuse.

**C. Require timely employer notification of claims.** During the workers' compensation breakout session many employers expressed frustration with the Department of Labor and Industries' existing claims notification system. Often weeks pass after a claim has been filed before the employer learns about the claim. Employers

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<sup>7</sup> Two state audits of the workers' compensation system, one released in 2003 by the State Auditor and another released in 1998 by the Joint Legislative Audit and Review Committee (JLARC), found that fraud by benefit recipients, while not a major problem, is still common and could be reduced through reasonable reforms. "Claims and Benefits Performance Audit," prepared by Miller and Miller Consulting for the Washington State Auditor, February 2003, and, "Workers' Compensation System Performance Audit," prepared by Edward M. Welch for the Joint Legislative Audit and Review Committee, December 1998.

<sup>8</sup> See Washington Administrative Code 296-20-065.

want to maintain a safe workplace, and immediate notification of a workers' compensation claim will better allow them to fix any previously unknown safety problems, helping to avoid further injury. More timely notification of employee claims will also help ensure that the injury was sustained on the job and not from a weekend football game or other non-work-related source.

**D. Competitively contract for case management to avoid backlogs.** This innovative recommendation can increase flexibility for the Department of Labor and Industries without requiring the Department to hire new staff.<sup>9</sup> Small business owners often find that customer service suffers because staffing levels within the Department are inadequate. With the added flexibility offered by contracting out case management services, the Department can ensure prompt customer service even during times of heavy workloads.

**E. Electronic claims information exchange.** A company's injury history is a major factor in determining its industrial insurance premium rate. A company with more injuries than the average for the industry will typically have to pay higher than average workers' compensation rates. A company with fewer injuries, and by assumption a safer workplace, pays a lower rate.<sup>10</sup>

Improving electronic access to claims information offers an important opportunity for the state to reduce workplace injuries and improve communication with businesses. Small business owners recommend two key reforms. The first is allowing online access to company claims history and expanding the use of e-mail for exchanging information, offering an option to the outdated and inefficient call-center system used today.

Second, small business owners feel the state could help encourage a safe workplace and also help reduce the cost of industrial insurance by allowing companies to check the workers' compensation claim history of prospective employees through an electronic claims information exchange. This recommendation, while controversial, would add another positive incentive for workers and employers to work together to identify and prevent safety hazards, and give employers another tool to help ensure they have a safe and productive workplace. By hiring workers with a good safety history, employers can play a productive role in further reducing workplace injuries.

**F. Deny Workers' Compensation for workers who test positive for drugs.** Because of privacy and cost concerns many small businesses cannot test their employees for drugs on a regular basis. Many workplace injuries are the result of drug use.<sup>11</sup>

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<sup>9</sup> The Department employs 250 claims managers. Despite fluctuations in workload, the number of case managers has not changed over the past five years. Information provided by Department of Labor and Industries Public Affairs staff, December 12, 2003.

<sup>10</sup> A detailed look at how an employer's industrial insurance rate is determined is available in the Department's "Employers' Guide to Industrial Insurance," available online at [www.lni.wa.gov](http://www.lni.wa.gov).

<sup>11</sup> A national study shows that between five and ten percent of all full time workers regularly use illicit drugs. The study also found that substance-abusing workers were 3.6 times more likely to be involved in an on-the-job accident. "Worker Drug Use and Workplace Policies and Programs," published by the US

Allowing the state to deny workers' compensation benefits to an employee who tests positive for illegal drugs will help increase workplace safety, reduce workers' compensation rates and introduce strong incentive for workers to promote safe work habits.

**G. Allow compromise and release.** Compromise and release is an option that allows the Department to pay out benefits immediately as a lump-sum payment based on an estimate of the claimant's benefits over the life of the claim. In some cases this alternative can simplify the administrative requirements of a claim and allow an injured worker to have greater flexibility over how to use his or her benefits. Some form of lump-sum payment alternative is common in most other states, providing a key alternative that can help reduce the cost and complexity of addressing a workplace injury.

## 2) Wage simplification

Small business owners recommend simplifying the process the Department of Labor and Industries uses for calculating benefits for injured workers. The existing system, which can be vague and confusing, has resulted in costly court cases stipulating expensive and overly generous benefits for injured workers. The cost, uncertainty and administrative burden of the existing wage calculation system can be reduced through two key wage simplification reforms.<sup>12</sup>

**A. Fix the Cackle and Avundes court cases.** Two recent court cases have significantly increased the cost of wage replacement benefits in the state's workers' compensation system. The first is *Cackle v The Department of Labor and Industries*, which requires the Department to include various employer paid benefit costs in the calculation of wage replacement benefits.<sup>13</sup> The decision increased wage replacement benefits by an estimated \$124 million each year. The second, *Avundes v The Department of Labor and Industries*, lays out an overly generous method for calculating the wages of people who work only seasonally or part time, with many receiving far more in benefits than they ever received from working.<sup>14</sup> Under the ruling, benefits are calculated using the wage the worker was making at the time of injury, not an average over the previous twelve months.

**B. Pay claims based on a flat rate instead of a calculated rate.** The rate of wage replacement for an injured worker receiving workers' compensation benefits is

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Department of Health and Human Services Office of Applied Studies, July 1, 2003, available online at [www.samhsa.gov](http://www.samhsa.gov).

<sup>12</sup> Many of the small business-backed recommendations for wage simplification were included in last year's failed Senate Bill 5378. The bill, introduced by Senator Jim Honeyford, would help address many small business concerns by changing the way wages are calculated to better reflect a worker's recent wage history, eliminating fringe benefits from the calculation of wage history and changing the compensation rate from a sliding scale between 60 and 72 percent to a flat rate of 65.5 percent. The provisions of SB 5378 are estimated to save workers and employers \$160 million in the first year and over \$20 million per biennium in the future.

<sup>13</sup> *Cackle v Department of Labor and Industries*, 142 Wn.2d 801 (2001).

<sup>14</sup> *Avundes v Department of Labor and Industries*, 140 Wn.2d 282 (2000).



determined by a formula that offers a different level of benefits depending on the worker's marital status and number of dependents. The complicated and litigious process requires the agency and self-insurers to continually verify a worker's marital status and number of dependents, adding unnecessary cost and delay to the claims management process. The average payout under the current system is 64.5 percent. Revising the process to a system using a flat rate will significantly simplify the process of wage calculation and standardize Washington's workers' compensation policy with that of 90 percent of the rest of the nation.<sup>15</sup>

### **3) Increase providers/risk mitigation options**

Washington is one of only five states that do not allow businesses to buy workers' compensation insurance in the private market.<sup>16</sup> Not surprisingly, prices rise when customers are required by law to buy a product from a single source. In most other states employers are offered a choice of 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 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 about one third of total premium costs, a provision largely supported by small business owners. Also, industrial insurance premiums in Washington are based on hours of work while most other states base premium rates on company payroll.

The Nevada experience (below) illustrates the strong argument in favor of allowing competitive choice in workers' compensation for Washington small businesses. Another example is Oregon, where more than 200 insurance companies offer workers' compensation plans tailored to the specific needs of businesses and employees. To protect the interests of workers, an Ombudsman for Injured Workers helps employees, employers and insurance companies quickly resolve disputes.<sup>17</sup> In Idaho, 270 private

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<sup>15</sup> Forty-five other states use a flat rate to calculate wage replacement benefits.

<sup>16</sup> Ohio, North Dakota, West Virginia and Wyoming are the others. See "State Funds: Their Role in Workers' Compensation," American Association of State Compensation Insurance Funds, January 2001, at [www.aascif.org](http://www.aascif.org). The only allowed competition to the state system comes from a limited number of self-insured companies. These typically large businesses are allowed to provide their own industrial insurance, but benefit payouts are still subject to the state's overly generous compensation rules.

<sup>17</sup> For more on the Oregon workers' compensation program see [www.cbs.state.or.us/external/wcd/](http://www.cbs.state.or.us/external/wcd/).

companies offer insurance coverage in the workers' compensation market.<sup>18</sup> The experiences of other states clearly shows that vigorous market competition would ease the heavy burden on Washington small businesses and provide better protection for workers.

#### **Workers' Compensation Privatization - The Nevada Experience**

In 1999 the Nevada legislature allowed private companies to provide workers' compensation insurance in a competitive market. 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 competitive.<sup>19</sup>

Nevada provides a useful example of how a successful privatization plan can meet the needs of Washington workers and businesses. The result is a system with vigorous competition, strong worker protections and a number of successful private providers. More than 100 private providers now offer workers' compensation insurance in Nevada and rates have fallen 20 percent since inception of the system. Rates will be reduced an additional 12 percent in 2004. Among the many success stories is Employers Insurance Company of Nevada, formerly the state monopoly system that was privatized in 1999 and now is one of the state's largest providers of workers compensation insurance.<sup>20</sup>

#### **Unemployment Insurance**

Washington's unemployment insurance system carries the second highest cost per employee, behind only Alaska. While the tax *rate* is not higher than most states, businesses in Washington must pay that rate on the first \$30,200 of salary for each employee, the highest base wage in the nation. Businesses in most other states only pay unemployment taxes on the first \$7,000 to \$10,000 of an employee's salary. Washington's maximum weekly unemployment benefit is also very high, ranking second in the nation behind only Massachusetts.<sup>21</sup>

The high cost of Washington's unemployment insurance system was a major subject of the 2003 Legislative Session. To help slow cost increases, the legislature passed major reforms to the system, most of which take effect in January 2004. The reforms include: returning the maximum weekly benefit to \$496, or 63 percent of the state's current average weekly wage, reducing the maximum time an employee can collect unemployment benefits from 30 to 26 weeks (at the national level, Congress recently approved up to 13 weeks of additional unemployment benefits for workers that exhaust their state benefits), changing the benefit calculation to include a full year of work, not just the two highest paid quarters, reducing the number of voluntary-quits that

<sup>18</sup> For more information about the Idaho workers' compensation program see [www2.state.id.us/iic/](http://www2.state.id.us/iic/).

<sup>19</sup> Information from author interview with Chuck Knaus, Nevada Division of Insurance, December 9, 2003.

<sup>20</sup> Information from the office of Nevada Governor Kenny C. Guinn, November 12, 2003, available online at [www.gov.state.nv.us](http://www.gov.state.nv.us).

<sup>21</sup> Information from, "Unemployment Insurance Data," and analysis prepared by the House Commerce and Labor Committee staff, May 9, 2003, Olympia, WA.

are eligible for benefits and allowing certain people to work part time without losing their benefits. The new law also creates a new tax schedule for businesses and caps the tax rate at 6.5 percent for most businesses and 6.0 percent for certain seasonal industries.<sup>22</sup>

It is important to note that even with these changes, the cost of the Washington system will remain almost twice the national average. In addition, some small businesses will actually see an increase in Unemployment Insurance costs as the tax burden is redistributed. For this reason, state policymakers should consider the recommendations of small business owners for further reducing the cost and improving the performance of the existing system.

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### **Top Small Business Recommendations**

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#### **1) Reduce benefits to be more in line with the national average.**

History shows high unemployment benefits increase unemployment.<sup>23</sup> At a certain point the incentive to remain on unemployment is greater than the incentive to work. Further study illustrates that job finding activities and formal job placement rises dramatically in the final few weeks of benefit eligibility.<sup>24</sup>

Further limiting unemployment benefits will accomplish two important goals. First, it will reduce unemployment by improving the incentive for those currently out of work to find a job. Second, by reducing benefit levels, policymakers ease the burden on small businesses to pay for the system, leaving more money to create new jobs and buy new equipment.

One way to establish a more reasonable level of benefits is by tying Washington's benefit levels to a national average. By targeting a more consistent national standard for average weekly benefits and maximum weekly benefits, Washington policymakers can reduce the cost of the unemployment insurance system and help ensure a competitive business climate while maintaining necessary worker protections.

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<sup>22</sup> For a more detailed explanation of the changes made to the state's unemployment insurance system, see a summary and the full text of SB 6097 at [www.washingtonvotes.org](http://www.washingtonvotes.org).

<sup>23</sup> A study of Britain's unemployment insurance system during the 1920s illustrates how high unemployment benefits can encourage workers to stay off the job. At a time when Britain and the rest of the world was producing more goods and enjoying unprecedented economic growth, British unemployment remained at more than 15 percent. The government's inordinately generous unemployment insurance system encouraged workers to remain jobless even when jobs were readily available. For more information, see "Searching for an Explanation of Unemployment in Interwar Britain," by Daniel K. Benjamin and Levis Kochin, *Journal of Political Economy*, 1979, vol. 87, num. 3, pp 441-78.

<sup>24</sup> The likelihood someone receiving unemployment benefits will find a job more than doubles in the last four weeks of benefit eligibility. In many cases, extending unemployment benefits does little to help the unemployed find work and may actually increase unemployment. See, "Unemployment Insurance and Unemployment Spells," by Bruce D. Meyer, *Econometrica*, Volume 58, Edition 4, July 1990, pp 757-82.

## 2) Provide better incentives for workers to get back to work.

Most unemployed workers in Washington genuinely want to find a steady job. However, the state's artificially high unemployment benefits encourage some workers to take advantage of the system and continue receiving benefits even when reasonable work opportunities are available.<sup>25</sup> Small business recommendations for improving workers' incentives for returning to work include:

**A. Require training sessions or community service.** Part of the allure of staying on unemployment while only satisfying the state's minimum job search requirements is the opportunity to pursue personal interests uninterrupted. Introducing new service or training requirements for unemployed workers will improve the incentive for them to return to work. As an example, unemployed workers would be required to volunteer for non-profit organizations or attend state-sponsored job training.

**B. Increase benefit compliance audits.** In a recent performance audit, State Auditor Brian Sonntag offers praise for the Employment Security Department's fraud protection practices, pointing to the Department's automated claims management system as a model of efficiency.<sup>26</sup> Ironically, many small business owners feel it is this system that is helping to encourage employable workers to stay home. Small business owners recommend increasing audits of people receiving benefits to ensure they are complying with job search requirements.

**C. Provide wage subsidies for low skill jobs.** One unique and promising example of reform is Oregon's Jobs Plus program.<sup>27</sup> The program, implemented in 1990 through a citizens' initiative, subsidizes entry-level jobs for unemployed workers with money that would otherwise fund cash benefits. While Oregon continues to struggle with a high unemployment rate, the Jobs Plus program has been particularly effective at improving opportunities for low-skilled and young workers.

## 3) Implement personal unemployment accounts.

In 2002 Chile privatized its unemployment insurance system.<sup>28</sup> Under the new system, workers pay 0.6 percent of their wages into an account administered by a private fund and employers contribute 2.4 percent. A portion of the funds go into the general

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<sup>25</sup> Workers who are not eligible for unemployment insurance tend to find jobs more than twice as quickly as those who receive some type of benefits. See, "Measuring the Influence of Unemployment Insurance on Unemployment Experiences," by Mark Gritz and Thomas MaCrudy, *Journal of Business and Economic Statistics*, Volume 15, Number 2, April 1997.

<sup>26</sup> "Claims and Benefits Performance Audit," published by the Washington State Auditor, October 31, 2002, available online at [www.sao.wa.gov](http://www.sao.wa.gov).

<sup>27</sup> For a more detailed analysis of the Jobs Plus program see, "Final Report on the Jobs Plus Program," by William B. Conerly and John W. Courtney, the American Institute for Full Employment, March 1, 2001, available online at [www.fullemployment.org/library](http://www.fullemployment.org/library).

<sup>28</sup> Adopting a private system for unemployment insurance would require a special federal waiver and changes to state law.

fund to cover young workers and those who cannot contribute enough into their account to meet the minimum level of benefits.<sup>29</sup>

Key to the success of Chile's program is individual control of personal benefits. An unemployed worker can receive tax-free benefits of up to 50 percent of their previous wages for up to 5 months. In contrast to the Washington system, unemployed workers can collect benefits any time they are out of work, whether they were laid-off, fired or chose to leave. Strict qualification limits are not required because workers control their own benefits.

Perhaps the most promising part of Chile's system is the long-term incentive for saving unemployment benefits. At retirement, workers can keep any money remaining in their account. Washington's system has no such provision. A worker in Washington, who is never unemployed, receives no refund or benefit when they retire. Workers in Chile get to keep any money they do not use.

## **Workplace Regulations**

Local, state and federal regulatory agencies exercise tight control over workplace practices of Washington employers. Small business owners identified three important parts of the workplace regulation system that present considerable barriers to their success. Those regulations are the recently repealed Ergonomics rule, the minimum wage rule approved by voters in 1998 and minor work rules, which limit the work conditions and hours for workers under eighteen.

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### **Top Small Business Recommendations**

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#### **1) Stop Implementation of the Ergonomics Rule and Focus Instead on Education**

In May 2001 the Department of Labor and Industries adopted new workplace rules designed to restrict certain stressful or repetitive job related actions. The new ergonomics regulation was the most restrictive in the nation, creating complex Caution Zone and Hazard Zone limits that many employers found confusing and often unnecessary.<sup>30</sup>

Voters agreed that the rules would be bad for the business climate, and in November 2003, approved Initiative 841 to repeal them and forbid the state from implementing new ergonomics rules without direct Federal authorization. Small business owners shared the sentiment of Washington voters during the Conference breakout

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<sup>29</sup> Data about the Chilean system from "Chile Will Privatize a New Span of its Noted Social Safety Net," by Larry Rohter of the *New York Times*, June 24, 2002, available online at [www.nytimes.com](http://www.nytimes.com).

<sup>30</sup> For a more detailed look at the proposed Ergonomics rule, see, "An Overview of Initiative 841," by Paul Guppy, Washington Policy Center, October 2003, available online at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

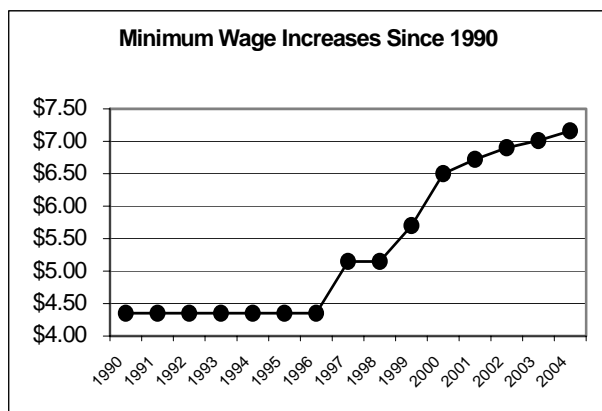
session on Workplace Regulations. In this session the number one recommendation of small business owners was to stop implementation of the Department’s ergonomics rule and to focus instead on educating employers and workers on how to voluntarily reduce workplace musculoskeletal injuries.

Experience indicates this new approach will be successful. According to business groups, voluntary improvements have reduced workplace musculoskeletal injuries by 18 percent since 1980.<sup>31</sup> With further research on how to prevent musculoskeletal injuries and greater awareness by employers and workers, the rate of injury will continue to go down, even without new state or federal regulations.

## 2) Introduce full-employment trigger for increasing minimum wage.

Washington’s mandatory minimum wage increases automatically every January 1, in accordance with a citizens’ initiative passed in 1998. The amount of yearly increase is pegged to the Puget Sound cost of living, the highest in the state. This January the minimum wage will again increase from \$7.01 to \$7.16 an hour, making it the highest in the nation.<sup>32</sup> Figure 1 shows the increase in minimum wage since 1990.

*Figure 1*



It is a basic tenet of economics that when the price of something goes up (labor), the demand for it goes down (fewer jobs). This relationship is particularly apparent in small business, where small changes in overall costs have a large impact on business operations. By one estimate, between 1998 and 2001 Washington lost 30,000 jobs and increased poverty by more than 30 percent as a result of mandated minimum wage increases.<sup>33</sup> This is

reflected in Washington’s continually high unemployment rate, averaging over 7 percent statewide and reaching 14 percent in some rural counties.

Small business owners are the first to feel the impact of increases in the minimum wage. Small wage increases lead to cutbacks in other areas, particularly for businesses struggling to survive in a poor business climate. For this reason, business owners recommend limiting increases to the minimum wage as one of their top priorities for

<sup>31</sup> Association of Washington Business Ergonomics fact sheet, available online at [www.awb.org](http://www.awb.org).

<sup>32</sup> “Washington State Minimum Wage History,” published regularly by the Washington State Department of Labor and Industries, available online at [www.lni.wa.gov](http://www.lni.wa.gov).

<sup>33</sup> “The Economic Impact of Washington’s Minimum Wage Law,” by Richard Vedder and Lowell Gallaway, Ohio University, published by the Washington State Job Creation and Retention Coalition, January 2003, Olympia, WA.

improving the business climate. In particular, they recommend delaying increases in the minimum wage when Washington's unemployment rate is higher than the national average.

### **3) Rely on federal workplace standards before creating new state regulations.**

Many state policymakers like the image of Washington as a progressive state with strong workplace protections, but small business owners feel some of the state's progressive policies unnecessarily limit competitiveness. Examples of Washington's tendency toward over-regulation are found in the job-killing yearly minimum wage increases, an overly generous workers' compensation system and the recently defeated proposal for a statewide ergonomics rule.

The efforts of Washington state regulators to provide extra protections for state citizens often lead to agencies and regulations that overlap in their purpose and jurisdiction. One example is the worker lifting regulations implemented by both the federal Occupational Safety and Health Administration (OSHA) and the Washington Industrial Safety and Health Act (WISHA). Both standards are designed to prevent workplace injury, but because they rely on two different measurement and enforcement standards, businesses must comply with an extra set of regulations.

The state's restrictive and counter-productive minor work rules are another example of how state regulators limit opportunity for Washington workers and businesses.<sup>34</sup> While reasonable regulations are needed, in many circumstances state restrictions go much farther than federal work rules, limiting the ability of qualified young people to receive the training and experience they need to become good workers once they are on their own. By limiting state regulations to more closely meet the

#### **Four Keys to Understanding Minimum Wage**

(1) For most workers, the wage is supplemental. A vast majority of those earning the wage are teenagers and college student on their first job or part time workers who live with another full-time wage earner. When the minimum wage is increased, these jobs are the first to be eliminated by employers who must reduce marginal costs to stay in business.

(2) The minimum wage was never intended to support a family. Many state, national and private social programs are devoted to helping those who need assistance. Reducing the number of entry-level jobs by increasing the minimum wage does little to lift struggling families out of poverty. If anything, it often leads to increased unemployment because teens and second-earners are the first to lose their jobs when employers cut costs.

(3) Income mobility is an important aspect of the American economic system. Through hard work, savings and investment most poor families do not stay poor for long. A recent study shows that the greatest gains in income are among those who start off at the lowest end of the income ladder.

(4) The health of our state's economy, and small businesses in particular, requires that government regulations not artificially increase the cost of entry-level labor. Jobs that require little skill or experience should not pay as much as those that require more specialized abilities. Every increase in the cost of these low-wage workers provides another incentive for employers to transfer the workload to other more experienced workers or buy machinery that can perform the tasks of low-skilled human labor.

<sup>34</sup> For more information about the details of Washington's minor work regulations, see WAC 296-125. Available online at [www.leg.wa.gov](http://www.leg.wa.gov).

reasonable standards already established by the federal government, policymakers can create more opportunity for young workers while ensuring a healthy and safe work environment.

## **Rising Cost of Health Insurance**

Paying for health care coverage is one of the fastest-rising costs facing businesses and families in Washington. At the same time, health insurance is one of the most heavily regulated sectors of our state's economy. According to an NFIB survey of small business owners throughout Washington, employers who offer health care coverage for all employees has dropped from 65 percent in 1993 to only 47 percent today. Many small employers report health insurance rate increases of 20 to 30 percent each year for the past several years.

Participants in the first phase of the Small Business Project identified the cost and availability of health care as the number one concern of small business. Business owners voiced particular concern about the way state-imposed mandates drive up health coverage costs for small firms. Health insurers in Washington are required by law to cover a broad range of illnesses and treatments, meaning employers are often paying for coverage their workers do not need. The large number of state-imposed mandates means basic, low-cost health coverage is currently illegal in Washington.

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### **Top Small Business Recommendations**

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The health care system in Washington is governed by a complex and confusing combination of local, state and federal laws, regulations and mandates. Small businesses are the first to suffer from the confusing web of red tape. Increases in health insurance costs are forcing many small business owners to reduce or eliminate health care coverage for their workers and themselves. With the following reforms, state policymakers can help address a top priority of small business owners and help improve the health of Washington workers.<sup>35</sup>

#### **1) Cap non-economic damages for medical malpractice cases.**

The prospect of multi-million dollar payouts is a major component of rising malpractice insurance costs for our state's doctors. When insurance rates increase, the cost is passed on to consumers in the form of higher doctor bills and higher health insurance costs. Washington's lack of a non-economic damage cap attracts lawyers with a "jackpot justice" mentality, driving up the number of frivolous lawsuits and significantly increasing legal costs for the medical community. The American Medical

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<sup>35</sup> Perhaps most important for reducing the cost of small business health insurance is gaining a greater understanding how the system works. Following are four useful online resources for small business owners: [www.health-insurance-plan-quotes.com](http://www.health-insurance-plan-quotes.com); [www.healthinsuranceindepth.com/group-health-insurance.html](http://www.healthinsuranceindepth.com/group-health-insurance.html); [www.info.insure.com/business/grouphealth/faq/index/html](http://www.info.insure.com/business/grouphealth/faq/index/html); [www.small-business-medical-insurance.com/health-insurance-information/index.html](http://www.small-business-medical-insurance.com/health-insurance-information/index.html).



Association identifies Washington as one of twelve states facing a medical malpractice crisis that threatens health care access for small businesses and, most importantly, risks the health of patients.

Placing reasonable limits on medical malpractice awards to help slow the increase in health insurance costs is a top priority for small business owners. Unlike many states, Washington law allows juries to award an unlimited amount of money to patients injured by the negligence of a doctor. Under most tort reform proposals, collection of economic damages, such as loss of past and future earnings and the full cost of medical care would remain fully funded, but skyrocketing non-economic damage awards would be reasonably limited.

Washington needs reforms similar to those that are successfully reducing costs while protecting patients in other states. By allowing full economic damage recovery, applying reasonable limits to non-economic damages, encouraging the use of mediation and curbing plaintiff attorney fees, lawmakers can help reduce the cost of health care to Washington residents. In doing so, they will increase access for small businesses and assure that our state's best doctors are able to continue practicing medicine.

#### **California and Colorado Models of Successful Reform**

Seventeen other states have adopted some form of limitation on non-economic damages, many with broad bi-partisan support. Two states in particular offer useful examples of successful reform. In 1975 the California legislature approved the Medical Injury Compensation Reform Act, or MICRA. Under MICRA, malpractice claims in California are settled in one-third less time than the national average of more than five years and malpractice insurance rates have dropped 40 percent. The result is a system that better serves the needs of patients by reducing the cost of litigation and speeding compensation payments.

Reforms in Colorado have enjoyed similar success. Since adopting a MICRA-like system in 1988, average premiums have gone from increases between 20 and 70 percent a year, to average increases between one and nine percent today. Malpractice insurance costs for many medical professionals have actually dropped since the mid-1980s, reflecting the success of placing reasonable limits on the non-economic damages juries can award defendants.

## **2) Improve Small Business Access to Basic Health Insurance**

Business owners deal with competition every day. They understand that reduced barriers to entry will increase competition in the marketplace. For this reason, small business owners support a package of reforms that would increase competition and improve small business access to basic health insurance. The reforms recommended by business owners include:

**A. Allowing health insurance carriers to offer basic health coverage.** Current law mandates almost fifty different types of treatment for any health insurance plan issued in Washington state. Many small business owners cannot afford the “Cadillac” health plan that the state requires. By reducing the coverage requirements for the lowest

cost plan, small business owners could purchase a bare-bones plan at a low cost and with few mandates, rather than offering no health insurance at all.<sup>36</sup>

**B. Allow health insurers to adjust insurance rates based on the industry, age and wellness activities undertaken by the covered business.** This reform would reward small businesses for maintaining a safe and healthy working environment and would better allocate cost to those industries that place the highest burden on the health care system.

**C. Eliminate every category of provider requirement.** Existing law requires insurance plans to cover every type of licensed health-care provider for conditions covered under their plan. This provision limits the insurer's ability to direct patients to the most effective medical professionals. Removing this provision would allow insurers another way to reduce cost for small businesses looking for an affordable health insurance policy.<sup>37</sup>

**D. Allow insurers to cancel outdated insurance plans.** Current law prohibits insurance companies from closing unpopular plans with few subscribers. Allowing insurers to cancel plans and offer customers the option to move to a more popular plan would reduce administrative costs and increase the ability of insurance companies to tailor their products to meet market demands.

### 3) Allow 24-Hour Coverage

The idea of twenty-four hour coverage was first introduced in the early 1990s. The system is designed to manage all aspects of employee health in an effort to coordinate treatment, reduce costs and improve outcomes. To test the concept, other states designed pilot programs that allow private insurance providers to combine workers' compensation insurance and health insurance into one comprehensive plan. By combining the two plans redundancy in coverage between the two systems can theoretically be reduced, allowing doctors and insurers to better monitor and manage patient health.

While the concept offers a new alternative, successful implementation has been elusive. In California, a pilot program suffered from a lack of companies willing to offer the service, and a lack of customers (employees) willing to leave the old system to join the new.<sup>38</sup> Maine had a similar experience.<sup>39</sup> In both cases, traditional insurance

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<sup>36</sup> For an in-depth analysis of how mandates affect the cost of health insurance, see, "How Mandates Increase Costs and Reduce Access to Health Care Coverage," by Paul Guppy, Washington Policy Center, June 2002, Seattle, WA, available online at [www.washingtonpolicy.org](http://www.washingtonpolicy.org).

<sup>37</sup> In one example Regence BlueShield spent \$44.5 million in 2002 on alternative providers. Those costs have increased between 16 and 50 percent each year since 1996 when health plans were first required to cover every category of provider. "Bill Would End 'Alternative Provider' Mandate," by Peter Neurath for the *Puget Sound Business Journal*, February 24, 2003, available online at [www.bizjournals.com](http://www.bizjournals.com).

<sup>38</sup> "Evaluation of California's 24-Hour Coverage Pilot Demonstrations," by Gerald F. Kominski, Ph.D., et al, of the UCLA Center for Health Policy Research, prepared for the Robert Wood Johnson Foundation and the California Department of Industrial Relations, November 2001 at [www.healthpolicy.ucla.edu](http://www.healthpolicy.ucla.edu).

companies found it hard to expand their services from one market (health care) to another (workers' compensation). Also, in California, workers in more dangerous jobs were less likely to volunteer for the pilot program because they did not want to leave the existing, more generous system for one with which they were not familiar.

The unimpressive results of 24-hour coverage pilot programs offers a clear illustration of why improving consumer choice is vital to restoring patient confidence in the insurance market, and can also help reduce costs for small business. The current system, with a state-run workers' compensation insurance program, and a heavily regulated private market for health insurance, is inefficient, costly and redundant. Allowing consumers the choice to integrate their workers' compensation and basic health coverage in one private plan would provide a reasonable alternative for some small businesses, but experience shows it is not the best answer for most small business health care needs.

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## **Workforce Training**

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When asked what is the primary ingredient for business success, most small business managers will answer, "Good people." It is true, the backbone of most small businesses is the people hired to balance the books, build the machines, fix the computers and manage the employees. Without a qualified, capable workforce, small businesses find it difficult to meet the needs of their customers. As the world marketplace becomes more integrated and as new technologies are introduced, it is vital for Washington's education and training systems to work with the small business community to ensure graduates meet the evolving needs of businesses.

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### **Top Small Business Recommendations**

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Cultivating an educated and experienced workforce is important to the prosperity of Washington's small business community.<sup>40</sup> Having an adequate pool of qualified applicants to fill the workforce needs of local businesses is critical to maintaining the region's economic growth. Our workforce must adapt and grow at the same time, so our state's small businesses can compete with businesses in other regions of the world.

#### **1) Improve tax and regulatory incentives for small businesses to train workers.**

Large businesses have the resources to provide their own comprehensive, professionally developed job training programs. Small businesses struggle to provide

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<sup>39</sup> Letter to Maine State Senator Lloyd P. LaFountain, from Alessandro A. Iuppa, Superintendent of the Maine Department of Professional and Financial Regulation, titled, "Workers' Compensation 24-Hour Pilot Projects," published August 25, 2003 and available online at [www.state.me.us/pfr](http://www.state.me.us/pfr).

<sup>40</sup> The Washington Competitiveness Council, in their December, 2001 Report found improving the education system, both at the K-12 and higher education levels, is an important component of building a better business climate. The Council's full reports is available at [www.governor.wa.gov/wcc/wcc.htm](http://www.governor.wa.gov/wcc/wcc.htm).

similar training to their employees. Business owners say the time and expense necessary to implement job-training programs is just not feasible for most small firms.

To address these concerns, policymakers should consider a package of tax and regulation incentives that enhance the ability of small firms to offer continuing education and more advanced job-training alternatives. One alternative is a new tax credit for job-related educational expenses. By reducing the cost of educating the workforce, more employers will establish professional training programs or reimburse their employees for after-work training classes.

Another alternative is to revise the state's outdated apprenticeship rules that favor union workers at the expense of largely non-union small businesses. The state requires 15 percent apprentice workers on most public works projects. As a consequence, most non-union bidders without a state-approved apprenticeship program are barred from bidding on state projects. Most small businesses, because they are non-union, find it hard to meet state standards for program approval. Simple legislative changes will encourage worker training without discriminating against small business and non-union contractors.<sup>41</sup>

## **2) Enhance public perception of vocational and technical training and improve the educational system to better support vocational opportunity.**

Jobs requiring a college degree make up less than one quarter of all jobs, and demand for many occupations, like auto mechanics, computer programmers and health care technicians, is expected to increase over the next ten years.<sup>42</sup> In a recent poll of small business owners, a majority said the highest level of education they required for their employees was a high school diploma, 18 percent said two years of college and 17 percent said four years of college. Only 5 percent of small businesses said the majority of their employees had a post-graduate college education.<sup>43</sup>

There is growing concern among small business owners that the technical and vocational skills needed to meet the needs of a changing market are often not attractive to young students. Developing these skills through secondary and post-secondary education is vital to success in the business world and integral to developing the workforce of the future. As the economy evolves, a greater focus on non-university specializations will be needed, requiring a better focus and coordination from the business and education community in developing these vital workforce skills.

Traditionally, vocational and technical education has been discouraged or downplayed by media and the educational community. Young students are directed to

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<sup>41</sup> Washington's apprenticeship rules are overseen by the Washington State Apprenticeship and Training Council (WSATC) and governed by WAC 296-05.

<sup>42</sup> "High Earning Workers Who Don't Have a Bachelor's Degree," by Matthew Mariani, *Occupational Outlook Quarterly*, Fall 1999, p 13, available online at [www.bls.gov/opub/ooq/oophome.htm](http://www.bls.gov/opub/ooq/oophome.htm).

<sup>43</sup> "Small Businesses Seek 20<sup>th</sup> Century Skills for a 21<sup>st</sup> Century Workforce," published as part of *American Express Voices from Main Street* survey, June 26, 2000, available online at [www.americanexpress.com](http://www.americanexpress.com).

the universities, but not the technical colleges. Small businesses, however, have a pressing need for employees with technical and vocational skills. The rise of computer and technology-based businesses in the Puget Sound has created a need for skilled technical labor. By improving the marketing and community perception of these valuable educational opportunities we can begin addressing the workforce needs of Washington small businesses.

### **3) Coordinate better with business organizations to provide workforce training.**

Thirty-one percent of job openings in Washington require no more than a high school diploma or GED. Of the 60,000 high school graduates each year only about nine percent go on to vocational or technical school as a terminal degree, while 37 percent go directly from high school to work and the remaining 54 percent pursue a more advanced education. Of those employers that hire mostly workers with less than a four-year college degree, the most difficult skills to find are job specific skills.<sup>44</sup>

Because a large portion of the jobs in Washington do not require a four-year degree, it is important for high schools and technical colleges to tailor their programs to the skills needed in the job market, and also for education and community leaders to improve the perception of our state's vital trade and industry jobs. While it is important to have a well-educated workforce, it is also important to have a diverse workforce that can meet the many needs of the market. Doing so will help small businesses survive and improve the regional economy.

The Business Week program is a good example of the productive link that can be established between small businesses and the public education system. The program, sponsored by a coalition of businesses representing a broad cross-section of Washington industries, offers high school students an opportunity to develop a business plan, market a product and run a mock business for one week. Representatives from the sponsoring businesses participate in the program, offering advice and mentorship during the weeklong experiment in youth entrepreneurship. The program, in existence since 1975, had 201 participating schools during 2003.

## **Access to Technology and Telecommunications**

One area of the business climate debate that has increased in importance over the past two years is small business access to and use of e-commerce technology and broadband telecommunications services. The global marketplace is quickly evolving into a fully connected web of business communication. The government and many large businesses are swiftly moving their purchasing and contracting operations online.

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<sup>44</sup> "Demand, Supply and Results for Secondary Career and Technical Education," published by the Washington Workforce Training and Education Coordinating Board, January 2003, available online at [www.wtb.wa.gov](http://www.wtb.wa.gov).

Technology is increasing economic productivity to levels unimaginable just a short time ago.<sup>45</sup>

It is often difficult for small businesses, without the resources or technical expertise of a large, integrated company, to keep up with the latest changes in technology. This issue is particularly important to the success of small businesses because many of their suppliers, customers and competitors are increasing efficiency by moving their operations online. While broadband telecommunications technologies and services are available in a growing number of areas throughout the state, small businesses are often unfamiliar with available equipment and e-commerce applications. The high cost of expert consultants and training can also be difficult for a small business to shoulder.

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### **Top Small Business Recommendations**

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Counter-productive federal, state and local tax and regulatory policies hamper new investment in broadband infrastructure. In some parts of the state, like Tacoma, subsidized telecommunications ventures by local governments are undercutting existing private service providers and deterring future private investment. Without that investment, innovation will slow and high prices will continue to hurt many small businesses. The following small business recommendations would improve access and lower costs.

#### **1) Decrease taxes on communications services.**

Communications services in Washington face one of the heaviest tax burdens in the nation. By one estimate, telecommunications companies pay an average of 39 percent more in taxes than other industries. In Washington, telecommunications consumers paid \$492 million in taxes during 1999, which equaled more than 12 percent of total telecommunications revenue.<sup>46</sup>

The cost of cable television and broadband internet access is also heavily influenced by local franchise fees. The fees are imposed on private cable operators by local governments in exchange for allowing the cable operators to service the city or

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<sup>45</sup> The productivity increases made possible through technology improvements are vital to small business success. With increasing globalization, small businesses must continually increase productivity to ensure competitiveness. Improving government policies to increase access to broadband and technology innovations can play a vital role in improving Washington's small business climate. For more information on technology improvements and productivity see, "Small Business' Technology Usage Contributing to Increased Productivity and Growth," a study produced by The Network of City Business Journals, January 8, 2001, available online at [www.networkcitybiz.com](http://www.networkcitybiz.com), and, "Technology Raises Productivity," by Jeffrey Sparshott, *The Washington Times*, November 13, 2003, available online at [www.washingtontimes.com](http://www.washingtontimes.com).

<sup>46</sup> "Telecommunications Taxes: 50-State Estimates of Excess State and Local Tax Burden," by Robert Cline for *State Tax Notes*, June 3, 2002, pp 931-47. The average percent of telecom revenue paid in taxes for all 50 states is 9.1 percent. For an explanation of some of the taxes you see on your monthly phone bill, see, "Guide to Your Telephone Bill," published by the Washington Utilities and Transportation Commission and available online at [www.wuttc.wa.gov](http://www.wuttc.wa.gov).

county's cable customers. Between 1996 and 2002 nationwide local franchise fees rose from \$1.4 billion to \$2.2 billion per year, leaving the average customer paying more than \$30 per year just to cover the franchise fee.<sup>47</sup>

Reducing the tax burden on telecommunications providers would lower a major barrier to broadband access for small business. Lowering franchise fees and reducing the special tax burdens placed on telecommunications consumers will accomplish two key goals. First, small businesses located in areas already serviced by broadband and wireless communications will be better able to afford the service. Second, by lowering taxes on all consumers, telecom providers will have more capital available to invest in markets they do not yet serve, primarily in rural areas.

## **2) Expand broadband into rural areas.**

Advanced technology and communications systems continue to expand the ability of rural small businesses to compete with businesses located in urban areas. Integral to the continued growth of rural small business is the further expansion of broadband access. Rural areas are often slower to adopt new technologies because the population is more dispersed, average incomes are lower and infrastructure is less advanced.

Many different alternatives have been proposed for expanding broadband access for rural small businesses. One proposal is government-subsidized service provided by public utility districts. This proposal is often more costly than private alternatives and discourages future private investment in infrastructure and new services.<sup>48</sup>

A less costly and more flexible option is comprehensive tax and regulatory reform for the broadband communication industry. By reducing the barriers to entry for technology providers, policymakers can attract further investment in areas where service previously proved unprofitable.

One deterrent to broadband expansion into new rural markets is the regulatory price control of many state and local governments. The Federal Communications Commission (FCC) allows local utility districts and state commissions to regulate the prices paid for telephone and broadband internet services. Because prices are kept artificially low, communications companies have little incentive to provide service to outlying areas that are more expensive to reach.

By allowing companies to charge market rates for communications services, the FCC and local utility districts will do much to expand the reach of broadband service. With new technologies like voice over internet protocol (VOIP) and an expanded fiber

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<sup>47</sup> "Cable Pricing, Value and Costs," published by the National Cable and Telecommunications Association, May 2003, Washington, D.C., available online at [www.ncta.com](http://www.ncta.com).

<sup>48</sup> For a more detailed look at the publicly provided broadband service see, "When Government Enters the Telecommunications Market: An Assessment of Tacoma's Click! Network," by Paul Guppy, Washington Policy Center, June 2001, available online at [www.washingtonpolicy.org](http://www.washingtonpolicy.org), and, "Municipally Owned Broadband and Networks: A Critical Analysis," by Joseph Bast, Heartland Institute, November 2002, available online at [www.heartland.org](http://www.heartland.org).

optics infrastructure, private companies are finding a host of cost-effective alternatives for serving rural markets. Only through comprehensive regulatory reforms that allow local providers to charge market rates can policymakers ensure that innovative new technologies will reach small businesses and consumers in rural areas.<sup>49</sup>

### **3) Improve industry cooperation to establish standards.**

One sure way to limit innovation in broadband and wireless technology is for government officials to pick the winners and losers in the consumer technology market. The one-size-fits-all approach typically practiced by centralized government programs fails to address the many different needs of small business customers. There is no one technology that is best for the small business or rural market. Although cable and DSL are the most widely used technologies, neither is ideal in all locations. Also, the technology market is constantly changing and growing, with satellite, fixed wireless, mobile and fiber-optic offering new alternatives for expanding access in every region of the state.<sup>50</sup>

Government can play a useful role by facilitating cooperation in establishing industry standards among private technology companies. By helping facilitate independent standards groups at the state and federal levels, government can help ensure that the many needs of different industries are met in the most efficient way possible, avoiding political direction of the market and instead relying on consumer-driven demand.

## **Environmental Regulations**

Most existing environmental regulations are a direct response to the broad powers granted to state agencies by the 1971 State Environmental Policy Act (SEPA) and the Clean Air Act, the Clean Water Act and many other 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-style regulation and imposes an increasingly expensive burden on local residents and businesses.

It is important to note that small business owners are not interested in harming the environment. Instead, business owners are uniformly interested 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.

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<sup>49</sup> “Telecom Deregulation: It’s Time for That Call,” by John Rutledge, *Investors’ Business Daily*, November 24, 2003.

<sup>50</sup> The many alternatives available for broadband expansion in rural areas is explained in, “Rural Broadband: a Multi-Coloured Coat,” by Charlie Davies of Ovum Media, October 15, 2003, available online at [www.ovum.com](http://www.ovum.com).



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## Top Small Business Recommendations

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### 1) Compensate regulatory impacts on private lands.

Regulatory restrictions have a harmful effect on the value and use of private property. Generally, the court prohibits government from regulating real property to a point where it can no longer provide any economic benefit to the owner.<sup>51</sup> Small business owners feel the growing burden of environmental regulations threaten the viability of many businesses, and in some cases entire industries, particularly agriculture, timber and development-related industries that rely on property and resource use for sustainability and growth.

Nearly every small business owner we spoke with expressed a clear commitment to doing his or her part to protect the environment. Small business owners do not want to gut environmental protections. They want to establish a reasonable level of certainty in environmental regulation. Recent local, state and federal regulatory actions have placed complex and unpredictable limits on the use of private property, particularly near lakes, rivers and streams.<sup>52</sup> By ensuring that the government will provide fair compensation for the regulatory impacts on private property, policymakers can foster a more cooperative balance between property owners and our shared environmental objectives.

Also important is strengthening Washington's vesting protections for property development. Vesting is a promise from local and state regulators that a property owner who is in compliance with all environmental regulations at the time a development permit is issued will not be required to revise the development plan to comply with new policies implemented after the permit was issued. This process establishes certainty in environmental regulation of new developments. It is vital to ensuring property owners and developers can meet the housing and commercial needs of our growing community.

### 2) Regulate for results by allowing flexibility in meeting environmental standards.

Environmental regulations in Washington are notorious for focusing more on process than results. A common concern in the small business community is the strict control over the methods used to meet environmental standards. Many small business owners want more flexibility in determining the way in which environmental standards

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<sup>51</sup> In 1995 the Washington State Attorney General issued guidelines for state and local governments to evaluate potential regulatory restrictions on private property. "State of Washington Attorney General's Recommended and Advisory Memorandum for Evaluation of Proposed Regulatory or Administrative Actions to Avoid Unconstitutional Takings of Private Property," published by the Washington State Attorney General, March 1995, available online at [www.wa.gov/ago/pubs/takinss1395.htm](http://www.wa.gov/ago/pubs/takinss1395.htm). For a more detailed look at the Fifth Amendment "Takings" clause, see, "Private Property Rights: Principles, Perceptions and Proposals," by LaJuana S. Wilcher and D. Randall Benn of Winston & Strawn, Washington, D.C., prepared for Watershed 96, a conference of the US Environmental Protection Agency and available online at [www.epa.gov](http://www.epa.gov).

<sup>52</sup> The most common government imposed property restrictions cited by small business owners are local critical areas ordinances, the state Growth Management Act and shorelines regulations and federal Endangered Species Act regulations.

are achieved. By regulating for results instead of process, policymakers can work with business owners to develop innovative environmental regulations that protect the environment without threatening the operation of businesses.<sup>53</sup>

An example of a more flexible, outcome-based regulatory structure is the one implemented in New York in 1994. Governor Pataki created the Governor’s Office of Regulatory Reform, which he directed to favor, “market-oriented solutions and performance standards over command and control regulation.”<sup>54</sup> By maintaining strong environmental protections, while allowing flexibility in the way businesses meet environmental standards, New York has been successful in regulating for results.

### **3) Reduce regulatory overlap between different agencies and levels of government.**

Small business owners want more clarity in the environmental regulatory system. Governor Locke’s Competitiveness Council identified a number of areas where regulatory overlap is a problem. The Council found there are too many decision-making bodies, duplicative enforcement of the same laws by different agencies, agencies acting outside their jurisdiction, and too many sets of rules, regulations and appellate bodies.<sup>55</sup> All these factors lead to a complex, burdensome and inefficient system with a reputation for stifling small business growth and innovation. Small businesses would benefit, as would the state’s economy, if the Council’s recommendations were implemented.

## **Tax Burden**

Washington businesses shoulder almost 50 percent of the state’s tax burden. In our research small business owners expressed frustration with the state’s reliance on businesses to pay for costly government programs and a growing state government workforce.<sup>56</sup> High tax rates and the complexity of local, state and federal tax laws disproportionately affect small businesses because they are less able to absorb these costs. Simply understanding which taxes are owed is often discouragingly difficult for many small business owners.

The federal tax code provides an example of the growing tax burden. Federal tax law comprises 2,840 pages with 8,920 pages of accompanying administrative

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<sup>53</sup> The 2001 Competitiveness Council report shares the concern of small business owners. Speaking about environmental regulations, the report points out that, “Decision-making (by the Department of Ecology) is process-based, rather than outcome-based.”

<sup>54</sup> “New York: A Model for Regulatory Reform in Washington State,” published by the Washington Roundtable, August 2002, available online at [www.waroundtable.com](http://www.waroundtable.com).

<sup>55</sup> “Washington Competitiveness Council Final Report,” prepared by the Washington Competitiveness Council, December 2001, available online at [www.governor.wa.gov/wcc/wcc](http://www.governor.wa.gov/wcc/wcc).

<sup>56</sup> Between 1990 and 2001 the state added 21,008 workers to the state payroll. During the same time, Washington’s inflation adjusted per capita state and local government expenditures jumped \$1,416, from \$4,250 to \$5,666.

regulations.<sup>57</sup> Extensive local and state taxes are then added to the federal burden. The state alone collects nearly 30 different types of taxes, ranging from the widely known sales, property and business and occupation (B&O) tax to the less well-known refuse collection tax and brokered natural gas tax.<sup>58</sup> The state's tax structure stifles economic growth and erects high barriers to entry for small businesses.

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## Top Small Business Recommendations

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### 1) Permanently establish Priorities of Government budgeting process.

In 2003 state policymakers faced a biennial budget deficit estimated at \$2.6 billion. To help solve the shortfall, Governor Locke implemented a new system of budget prioritization. The Priorities of Government (POG) system enabled state policymakers to implement a balanced budget without imposing a general tax increase. The POG process allows budget planners to evaluate each agency activity based on the core function of the agency, rather than simply adding or subtracting money from existing agency programs. Prioritizing each government activity based on pre-established criteria allowed the Legislature to make informed decisions about which activities should be consolidated, reduced or eliminated.<sup>59</sup>

The Priorities of Government approach is vital to reducing the tax burden on Washington small business owners. By more effectively controlling the growth of government, policymakers will face fewer pressures to increase taxes on an already overburdened small business community. The POG system also improves the performance of state agencies by weeding out the least efficient and effective programs. Prioritizing government activities means the most valuable services will be preserved, while the programs that are reduced or eliminated are the ones that will have the smallest impact.

Small business owners would like to see two reforms in the POG system to make it more stable and effective. First, it is important to expand the prioritization process to all agencies in state government. In 2003 the Office of Financial Management was responsible for the full POG review of all state agencies using limited information provided by agency managers. Expanding the review process to make all agencies responsible for their own review will help broaden and institutionalize the concept of a regular, enterprise-wide budget review. Second, policymakers should consider legislation that codifies the POG system in the budget process. That would establish clear boundaries and guidelines for future budget planners and reduce the chance that political pressure will make the program ineffective.

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<sup>57</sup> "Capital Ideas," Volume 10, Number 1, National Taxpayers Union Foundation, Alexandria, Virginia, January 2002.

<sup>58</sup> "Outline of Major Taxes in Washington State," Department of Revenue, Olympia, Washington, December 2001, at [www.dor.wa.gov](http://www.dor.wa.gov).

<sup>59</sup> "Proposed 2003-2005 Budget and Policy Highlights," prepared by the Office of Governor Gary Locke, Olympia, Washington, December 17, 2002.

## **2) Reduce taxes for all businesses; don't just shift the tax burden.**

The proper function of taxation is to raise money for government. 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 and other extraneous purposes. A simple and fair tax system is an ideal way for advancing Washington's economic interests and promoting prosperity for its residents.

Unfortunately, short-term political considerations usually drive tax policy. Many states have so-called highly "progressive" tax regimes, which punish those who add more wealth to an economy. 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.

Faced with these pressures, policymakers should instead consider reforming the system to make it more user-friendly and less burdensome for small and minority businesses. Specifically, small business owners recommend reducing the multiple, fluctuating rates that cause much of the complexity in the existing system, and lowering overall tax rates to stimulate growth and development. By reducing complexity and rates policymakers can stimulate small business growth and ensure a healthy economic recovery and larger tax base.

## **3) Eliminate the complex and burdensome B&O tax and consider replacing it with a personal and business income tax.**

The tax burden in Washington falls particularly hard on small business owners. Almost 50 percent of all taxes are paid by businesses, the highest percentage of any western state. Perhaps more importantly, high tax rates translate into a complex and costly administrative burden. Monitoring, collecting and complying with Washington's Business and Operating (B&O) tax is a major concern of small business owners.

The tax, unique to Washington, is levied on gross sales over \$28,000 a year and imposes a significant burden on businesses struggling to reach profitability. The B&O tax is levied on *all* revenue above the minimum, even if the business is operating at a net loss. Newly erected businesses and those that are working through tough economic times are the hardest hit.

Absent reform of the B&O system, business owners are desperate for an alternative that is at least perceived as being less burdensome. For this reason, some recommend implementing a personal and business income tax. In contrast to the B&O tax, which is applied to all revenue over a minimum, the income tax only taxes profits, and by imposing the tax on individuals, the burden could be shared more equitably between business and individuals.

Some business owners may not have considered the strong economic evidence against implementing an income tax. Washington Policy Center research shows that an

income tax would have a catastrophic effect on the state economy and on employment. Using the Washington-STAMP economic model, WPC estimates an income tax, imposed at rates equivalent to the revenue projections of the existing B&O tax, would cost Washington 69,919 jobs and reduce disposable income by \$2.2 billion. The real effects of the new income tax would be a \$2,191 reduction in yearly disposable income for the average Washington worker.<sup>60</sup>

A better solution is available. Policymakers should consider reducing the administrative complexity of the B&O tax by reducing the number of rate classifications, increasing the small business exemption to help start-ups and struggling smaller businesses and lowering the overall rate for all businesses. Additionally, continuing the Priorities of Government process would help reduce the need for future increases to the B&O tax.

## **Liability and Tort Reform**

Skyrocketing health insurance costs, multi-million dollar court awards and a growing public awareness of the economic costs of uncontrolled litigation have forced tort reform to the front of small business owners' agenda. Doctors are among the hardest hit. Since 1997, the average cost of malpractice liability insurance for a family physician has increased 29 percent to almost \$10,000. Orthopedic surgeons have seen a similar 30 percent increase, to \$39,000 a year, and obstetricians have been forced to absorb a staggering 39 percent average increase, from \$37,000 in 1998 to almost \$52,000 today.<sup>61</sup>

Growing liability costs are having a surprising effect on the state's growth management objectives. Many contractors with experience in multi-family dwellings are finding it nearly impossible to obtain even reasonably affordable liability insurance.<sup>62</sup> Lawsuits for defects, mold and asbestos are forcing insurance companies to raise rates or pull out of the market for apartments and condominiums, leaving growth management planners with few options for increasing density while also providing affordable housing. Liability insurance rates are also driving up the cost of single-family houses, adding thousands to the already growing cost of a new home.<sup>63</sup>

Liability costs also have a direct effect on the cost of government. In 2002 plaintiffs filed 125 complex liability cases against state agencies, bringing the total number of court cases being defended by the Attorney General's office to 750 separate claims. This does not include the out of court settlement of approximately 250 cases each

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<sup>60</sup> The STAMP computer model is a tax-modeling program created by the Beacon Hill Institute at Suffolk University for evaluating tax policy changes in Washington state. For more information about STAMP, contact Washington Policy Center at (888) 972-9272.

<sup>61</sup> Recently Washington state was placed on the "red alert" list by the American College of Obstetricians and Gynecologists as one of the states where malpractice insurance is most expensive and hardest to find.

<sup>62</sup> "Courtroom Battles Over Building Defects Leave Condo Market Reeling," by Jane Hodges and Kristina Shevory, *The Seattle Times*, November 2, 2003, available online at [www.seattletimes.com](http://www.seattletimes.com).

<sup>63</sup> "Insurance Premiums Hammer Construction," by Scott Wyland, *The Olympian*, November 23, 2003, available online at [www.olympian.com](http://www.olympian.com).

year. During fiscal years 2001 and 2002, the state paid out over \$106 million in tort claims, with the largest increase coming in lawsuits filed against DSHS social workers.<sup>64</sup>

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### Top Small Business Recommendations

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Finding solutions to the rising liability costs of Washington's small businesses is vital to restoring the health of the state's business climate. Investment and innovation require business owners to take reasonable risks. Following are the top recommendations of small business owners for restoring a climate that encourages reasonable risk taking while maintaining necessary protections for workers and consumers.

#### **1) Limit construction liability through Condominium Act reform.**

Establishing a competitive market for single and multi-family home construction is vital to the growth plans of the entire state. The rapid rise in liability insurance costs threatens the health of the entire industry. For every increase in the cost of liability insurance, contractors must increase their prices to cover expenses. As housing prices skyrocket, fewer families qualify to purchase a home and affordable housing becomes more difficult to find.

At the urging of small business owners, homeowners and the construction industry, the 2003 Legislature considered a number of reforms that would help reduce the cost of liability insurance for contractors and consumers.<sup>65</sup> Small business owners want policymakers to continue to pursue the reforms proposed in 2003, including:

**A. Encourage arbitration in disputes about condominium defects.** As the result of a recent court case, binding arbitration is prohibited in cases involving construction defects and contractor liability.<sup>66</sup> By authorizing and encouraging arbitration, policymakers can reduce the pressure on the court system and help foster a more cooperative approach to solving contractor liability issues.

**B. Limit the scope of implied warranties.** Current liability law interprets the implied warranty responsibility of condominium contractors very broadly. Defects the buyer, through responsible due diligence, could have identified prior to purchasing the unit can lead to costly litigation. Allowing contractors liability protection against defects that a reasonable person would disclaim at the time of purchase will help reduce the cost of liability insurance.

**C. Appoint an expert oversight committee.** The changes recommended above will help establish a better balance between consumer protection and contractor liability,

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<sup>64</sup> By comparison, in fiscal year 1991 and 1992 the state paid out less than \$20 million. This is a five-fold increase in just ten years.

<sup>65</sup> The bill containing most of the recommendations of small business is ESSB 5536.

<sup>66</sup> A 2001 Washington State Court of Appeals decision, *Marina Cove Condominium Owners Association v. Isabella Estates*, held that binding arbitration clauses in condominium agreements are unenforceable under the Washington Condominium Act.

but more changes will likely be necessary. Small business owners recommend establishing a panel of experts that can recommend policy changes designed to maintain multi-family housing construction while providing adequate protection for Washington homeowners.

## **2) Allow evidence about the plaintiff's use of a seatbelt in auto accident cases.**

Current law does not adequately consider the safety precautions of the injured driver when establishing responsibility for injuries. The vague nature of auto accident liability law helped create the “ambulance chaser” lawyer. Existing laws offer considerable opportunity for plaintiffs to receive generous financial rewards for injuries that could have been easily prevented by using a seatbelt.

Many small business owners must use the state's roads and highways to conduct their business, and are very sensitive to increases in the cost of corporate auto insurance. Under current law, a defendant is not allowed to present evidence showing the plaintiff was not wearing his or her seatbelt at the time of the accident. That is true even though not wearing a seatbelt is against the law. By allowing the jury to know if people who file claims did everything they could to limit their own injuries, juries would be better able to establish true liability in auto accident cases.

## **3) Implement joint and several liability reforms.**

Current law governing civil litigation sets out the way a court determines, in most causes of action, the percentage of fault and the percentage of damages for which each party is liable.<sup>67</sup> A person is responsible for only that share of the damages that reflects his share of fault (severally liable) except in two cases: (1) when parties were acting in concert or when a person was acting as an agent or servant of another party; and (2) when the plaintiff was not at fault.

The second exception is a costly loophole that often allows plaintiff's attorneys to extract large settlements from parties that are only marginally involved in a case. In situations where the party primarily responsible for damage does not have much money, the plaintiff's lawyer will often go after other parties that may have some vague association to the cause of the civil action. Under the legal concept of joint and several liability, each defendant in a lawsuit, even those with minimal or partial legal responsibility, is held financially liable for the full amount of a damage award if other defendants are bankrupt, fail to carry insurance or have limited insurance coverage.

There are a number of alternatives for reforming joint and several liability law, all of which would provide small business owners with much needed protection from aggressive trial lawyers and unreasonable requirements for risk mitigation. Among the most common proposals are: Limit joint and several liability only to those parties found

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<sup>67</sup> RCW 4.22.070.

to be more than 50 percent responsible for the damages caused;<sup>68</sup> limit the application of joint and several liability only to economic damages;<sup>69</sup> and, restrict damage awards to no more than double the percentage of fault assigned to a defendant.<sup>70</sup>

#### **4) Cap non-economic damages for medical malpractice cases.**

Implementing a reasonable limit on the non-economic damages - such as pain and suffering - that can be collected by plaintiffs in medical malpractice cases is an important component of tort and liability reform. For a detailed discussion of this particular recommendation see the earlier section of this paper titled, “The Rising Cost of Health Insurance.”

The growing cost of liability insurance and the continued rise of multi-million dollar legal settlements require policymakers to take bold steps in reforming Washington’s legal system. With comprehensive reform to the tort law system, including the recommendations mentioned above, policymakers would increase the fairness of the tort and liability system, reduce unnecessary risk for small businesses, and ensure necessary protections for consumers and plaintiffs.

### **Conclusion**

Small business owners face a daunting array of complex and confusing tax and regulatory hurdles in their quest for business success. Recommendations for improving the overall business climate are well presented in reports from the Washington Competitiveness Council and the Washington Roundtable, but it is also important for the unique concerns of small business to be considered fully. While many issues are shared between all sectors of the business community, competing interests often drown out the voice of small business.

With the support of organizations like the National Federation of Independent Business, Independent Business Association, Association of Washington Business and more than 60 chambers of commerce across the state, Washington Policy Center is proud to present this Agenda for Reform report. Through bold leadership and a renewed commitment to reform, policymakers can now follow the recommendations of small business owners in making the changes necessary to revitalize Washington’s small business climate.

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<sup>68</sup> Minnesota recently implemented a similar reform, which, while a compromise, received support from many in the business community. “Minnesota Passes Long-Awaited Reform on Joint and Several Liability,” by Bridget Ahmann and Bruce Jones of Faegre and Benson, LLP, November 8, 2002, Minneapolis, Minnesota, available online at [www.faegre.com](http://www.faegre.com).

<sup>69</sup> Economic damages can include objectively verifiable monetary losses such as medical expenses, loss of earnings, burial costs, loss of business opportunities and loss of employment.

<sup>70</sup> Under this proposal, a defendant found to be 20 percent liable for damages could only be held responsible for 40 percent of the total award.



## About the Author



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**2003 Statewide Small Business Conference, October 3, SeaTac, Washington**

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## PARTICIPATING ORGANIZATIONS

Bellevue Downtown Association  
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Enumclaw Chamber of Commerce  
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