# 108th Congress - Small Business Record

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**Report by the House Small Business Committee**
**Democratic Staff**
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## Introduction

A strong small business sector is the most important component of a growing American economy. The 23.7 million small businesses across the country are the driving force of U.S. job creation – and with high unemployment remaining a widespread concern, their success is critical to our nation's future. These small businesses generate 60 to 80 percent of the net new jobs added each year, employ half of all private sector employees, and pay 44.3 percent of the total U.S. private payroll.

Small businesses make up half of the nation's private gross domestic product (GDP), and their reach and impact in the U.S. economy is extensive. Small businesses can be found throughout every industry and sector. They dominate the manufacturing and exporting industries, are the leading owners of restaurants and retail shops, and represent the majority of technology firms and construction companies nation-wide. Small businesses are the innovators of the economy, and are on the cutting-edge of new products. These companies produce up to 14 times more patents per employee than large corporations, and are twice as likely to succeed with their new innovations. It is because of this entrepreneurial and innovational spirit that small businesses are known as the "engine of the economy."

Our nation's entrepreneurs are also anchors in their communities, serving as civic leaders and catalysts for economic growth. Unfortunately, like many sectors across the country small businesses are facing challenging times. While small business owners often operate on the tightest budgets and struggle to meet their bottom line, this has become even more difficult due to skyrocketing healthcare, energy and operating costs. These trends and their impacts have been monitored in the Small Business Index (SBI), a quarterly report that evaluates the climate for small business. According to the SBI, U.S. entrepreneurs are currently facing the most difficult economy in almost a decade.

While small firms are struggling to keep their businesses operating, they are also facing a highly challenging marketplace due to rising international competition. U.S. entrepreneurs have proven that they can succeed in a global market – however, monetary and trade policies have left small businesses at a competitive disadvantage.

Assisting entrepreneurs access new markets would enable small firms to weather these difficult times. Even with a struggling economy, the federal marketplace has grown from $235 billion to $285 billion. This unprecedented growth should have created significant opportunity for small businesses. However, while many large corporations have reaped substantial benefits from this expansion, agency practices have severely limited the ability of entrepreneurs to access this market. As a result, opportunities for small businesses have failed to keep pace with the growth of the federal marketplace.

These barriers contribute to an economic landscape in which it is increasingly difficult for entrepreneurs to succeed. This is particularly concerning given that the Bush Administration and Congressional Republican Leaders promised at the beginning of the 108th Congress to make it one of the most small business focused in recent years. Their small business agenda ranged from pledging to address healthcare and regulatory costs, to opening the federal marketplace and providing much needed tax relief. As the108th Congress comes to a close, and despite having two years to implement needed reforms, all these issues remain unaddressed. The Small Business Record reviews 11 issues that were key to the small business community during the 108th Congress, and evaluates the impact of failing to respond to these critical concerns. The 11 items include the proposals from President Bush's small business plan, initiatives identified by small business groups as policy priorities for the 108th Congress, as well as issues highlighted during House Small Business Committee hearings, forums and roundtables.

The report also assesses the true benefit to entrepreneurs of initiatives enacted during the 108th Congress that were presented as small business relief. Accordingly, the Small Business Record does not endorse any of the specific proposals included in the report. It is solely meant to provide a progress assessment of issues raised as priorities by our nation's entrepreneurs, and serve as a tool to help policymakers implement changes needed to help small business owners succeed in our struggling economy.

## Access to Capital

All businesses need capital to succeed. Whether it is starting a new firm or expanding an existing company, entrepreneurs have great needs for affordable capital. Traditionally, small businesses with fewer assets to pledge as collateral, uncertain earnings, or high failure rates have had a more difficult time than larger businesses when it comes to securing necessary capital.

These combined factors can severely limit a small business' access to adequate capital. Research has indicated that small businesses often fail because they lack sufficient access to capital at start-up or during key growth phases. That is why access to capital is so important to the survival of small businesses.

Unfortunately, little has been accomplished during the 108th Congress to expand access to capital for small businesses. In fact, the 108th Congress will be remembered for its inaction on a wide range of access to capital issues spanning the Small Business Administration (SBA) loan programs, venture capital, business development companies, and basic financial services.

### Entrepreneurs Face Barriers in Securing Business Financing

Through a variety of lending and equity investment initiatives, the SBA has been able to meet the constantly changing capital needs of entrepreneurs. These programs provide a full spectrum of financing alternatives, including small loans to startups, long-term debt financing to maturing businesses, and venture capital to high-growth companies. Together, SBA's access to capital programs provide more than $20 billion in financing to U.S. small businesses. Broadening and modernizing these important programs is a primary goal of ***the Small Business Reauthorization and Manufacturing Revitalization Act of 2003 (H.R. 2802).***

This bipartisan legislation provides a plethora of solutions that would enhance entrepreneurs' access to capital. H.R. 2802 is the most comprehensive effort to modernize the SBA's loan programs in the last twenty years, yet it remains stalled due to administration objections and Republican leadership maneuvering. This bill would expand and streamline SBA's business financing programs, allowing lenders to do what they do best – get capital into the hands of small businesses so they can grow the economy and create jobs. It reduces the costs associated with SBA's flagship loan program, making capital more affordable to smaller companies. In order to meet the needs of our nation's entrepreneurs, H.R. 2802 expands the reach of the SBA's loan programs, enabling borrowers to apply for loans more easily and receive a decision on their loan applications more quickly.

Making matters worse is the year-long crusade by the Bush Administration to destabilize and undermine the country's largest small business lending program. In January, the SBA shut down the program because they had requested insufficient funds. The program was reopened, but with severe limitations on loan size. The administration refused to remove these caps for nearly three months, greatly restricting small businesses' access to capital during this period. Only after Democrats rallied support did Congress act to pass a short-term fix to reopen the program. In July, Republican Leadership led efforts opposing the funding of the 7(a) program, and instead advocated for an increase in cost on small business owners that receive loans. The most recent blow came when, due to congressional inaction, the Bush Administration raised the borrower and lender fees for the program – doubling the costs for many small business owners. In addition to the increase in fees, the size of SBA's 7(a) guarantee was reduced from $1.5 million to $1 million and small businesses' ability to use a 7(a) loan in larger financing packages was eliminated – a critical option for companies that need larger loans.

**Venture Capital Remain Elusive for Small Businesses**

The Bush Administration and the Republican Leadership have also stalled efforts that would bolster the venture capital industry. In recent years, venture capital funding has declined from a high of over $28.5 billion in the first quarter of 2001 to just over $4 billion in the third quarter of 2003. This decline has greatly limited the ability of small companies to secure equity financing, forcing them to look to other funding sources. Unfortunately, this decline is likely to continue, as the Bush Administration has failed to support the core program aimed at spurring venture capital investment – the Small Business Investment Company (SBIC) Participating Securities program.

Due to the administration's lack of support of the SBIC Participating Securities program, hundreds of new venture capital funds, representing millions of dollars will be lost. The White House delayed action on critical policy changes that could have salvaged the program.

This will devastate small businesses that were hoping to secure venture capital. In the last two years alone, the SBA approved nearly 50 SBIC Participating Securities firms under this program. In 2003, these firms made over 2,000 investments in small businesses totaling over $1.1 billion, with an average investment of almost $550,000. The SBA's failure to support this program will create difficult challenges for transportation, manufacturing, information technology, and scientific research companies that often rely on this program for venture capital.

The decay of the SBIC Participating Securities program will also make it more difficult for minority-owned firms to access venture capital. Minority-owned firms already face great obstacles in accessing venture capital, receiving less than 4 percent of venture capital investment. In 2003, 14 percent of the total number of SBIC program financings totaling $145 million went to minority-owned firms. An erosion in the SBIC Participating Securities program, which is responsible for nearly half of the SBIC program's investment, will likely lead to a substantial decline in the program's investment in minority-owned firms.

While the SBIC program was created to further encourage equity investment in small businesses, current law hinders its mission. Today, non-profit organizations, such as pension funds and university endowments, are deterred from investing in SBICs due to archaic investment laws. As a result, SBICs have received considerably less investment from these types of organizations, limiting the amount of capital they can provide to small businesses.

In order to address this problem and further encourage equity investment in small businesses, lawmakers introduced the ***Small Business Investment Company Capital Access Act of 2003 (H.R. 739)***. This legislation would modify investment laws to encourage such non-profit organizations to invest in SBICs. H.R. 739, which carries minimal taxpayer costs, would generate as much as $500 million per year in new investment for U.S. small businesses.

Additionally, Congress has failed to make important changes to initiatives targeted at increasing equity investment in low-income communities. The New Markets Venture Capital (NMVC) Program provides the framework for venture capital companies to make investments in areas that are not being served by traditional financing programs, and where other lenders are unwilling or unable to provide access to capital. Unfortunately, the Bush Administration's failure to support this program has limited its success in underserved areas. The administration has repeatedly blocked attempts to strengthen the NMVC program, failed to encourage more NMVC companies to enter the program, and abandoned efforts to bolster the incentives for investment in existing NMVC firms. As a result, small businesses will be unable to create the economic growth and new jobs that are desperately needed in low-income communities.

**High-Growth Entrepreneurs' Capital Needs Are Unmet**

While SBA's programs have provided small businesses with an expansive menu of financing options, high-growth companies often have specialized financing needs. Given the cash intensive nature of many of these firms, high-growth companies often seek out equity capital, which enables these businesses to grow without the additional burden of regular debt payments. To meet these companies' unique financing needs, ***the Increased Capital Access for Growing Businesses Act (H.R. 3170)*** was introduced.

This legislation expands access to capital for growing small companies. Given changes in securities regulation, Business Development Companies (BDCs) are having difficulty in carrying out their Congressionally-mandated mission of investing in small companies. By permitting BDCs to invest in a broad range of companies, BDCs will be better able to contribute to the economic development of communities, enabling these small firms to bring their products to market, expand their operations, and hire new employees. While this legislation has passed the House, Republican Leadership in the Senate has failed to move this important initiative – forcing many new and exciting companies to draw on more expensive sources of capital.

In another blow to growth oriented companies, the ***Stock Option Accounting Reform Act (H.R. 3574)*** has not been enacted. During the 1990s, stock options leveled the playing field and permitted start-ups to compete with Fortune 500 companies for talented employees. Instead of economic oligopoly, new firms sprouted up across the country, providing the critical mass for new industries and markets. Given the unmatched quality of entrepreneurial activity in the United States, it is critical to provide entrepreneurs with the financial means to start and develop their innovative ideas. H.R. 3574 does this by ensuring that smaller firms will be able to continue to use stock options as a means to attract talented employees and grow their businesses. Without H.R. 3574, entrepreneurs, including those operating companies that are yet to go public, will be dissuaded from issuing stock options. Without any other means to grow, these companies will be unable to expand and further contribute to the economy.

**Small Firms Continue to Face Inequities in Securing Capital**

Another barrier that small businesses face in accessing the capital they need for start-up, operation and expansion costs is a Depression-era law that prohibits interest bearing checking accounts. The law, enacted as part of the Banking Act of 1933, was meant to keep banks solvent during the Great Depression. Almost 70 years later, the law is still in effect, despite evidence that it is no longer valid, or necessary. In fact, a 1996 joint report issued by the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Office of Thrift Supervision stated that the law prohibiting payment on business checking accounts "no longer serves a public purpose."

This law creates a double standard – one for small business and another for large companies. Small businesses are banned from receiving interest on their business checking accounts when large corporations can exploit loopholes in the system, utilizing their vast resources, to avoid the ban.

A proposal is currently pending to eliminate Depression-era laws that restrict banks from paying interest on funds held in checking accounts. Small businesses are more likely to use basic checking account services than larger companies, which can often leverage their broader business relationship for more preferential deposit services. ***The Business Checking Freedom Act of 2003 (H.R. 758)***, which has already passed the House, addresses this problem by repealing such antiquated laws. But H.R. 758 continues to languish as the Bush Administration and Congressional leaders have refused to further advance the proposal.

Although the financial services industry has witnessed great change in the last two decades, small businesses have seen few gains, while large corporations benefited considerably. In order for small firms to reap some of these benefits, the SBA's loan and equity programs need to be modernized and streamlined, and obsolete banking laws must be repealed. Today, small companies continue to face higher capital costs, unfavorable tax regimes, and less competitive financial services products. With the failure to move on these important initiatives, small businesses will continue to struggle for success.

## The Budget

The budget establishes the administration's priorities for the coming fiscal year, and significantly impacts our nation's small businesses. Ideally the budget can serve as a tool to encourage small business job growth and expansion, by increasing investments that support small companies. Through access to capital, entrepreneurial development, and community development and technological upgrades, these programs help small businesses overcome their unique challenges and increase their competitiveness in the economy.

At a time when small businesses have been called upon to reverse job losses and generate economic stimulus, the FY2005 budget severely underfunds and even eliminates crucial small business initiatives. By shortchanging these programs, small businesses will be unable to fully grow and prosper, and our nation's economy will continue to struggle.

**Limited Support for Access to Capital Programs**

The Bush administration's FY05 budget request fully abandons the federal government's role in making capital more accessible to small businesses. The administration terminated the Microloan program. This key initiative assists entrepreneurs with startup capital, and provided $26.5 million in loans and $15 million in technical assistance last year. The administration wrongly contends that very small loans to startups are more widely available now than they were a decade ago when the SBA began the Microloan program. The administration also eliminated funding for the 7(a) program, and shifted the entire cost of the program to entrepreneurs and small business lenders. These new costs – akin to a tax increase – will substantially limit small businesses access to 7(a) loans, and drive many lenders out of the program. By abandoning the federal government's historic role in supporting this program, the FY05 budget eliminates the only resource many small businesses have to access capital. Further, the administration provided no funding for the New Markets Venture Capital program, the federal government's primary initiative to increase equity investment in low-income communities. As a result, entrepreneurs in low-income areas will have limited access to equity investment. By eliminating key access to capital programs, the Bush administration not only stunts the expansion of small businesses, but also harms local communities already struggling to rebound from a failing economy, record unemployment and growing poverty rates.

**Investment in Low-Income and Rural Communities Lacking**

From urban areas to rural towns, many communities in this nation are cut off from the economic mainstream. The development of small businesses provides these communities an opportunity to grow their local economies. Programs are currently in place to provide direct assistance, loans and grants to stimulate small business expansion in urban and rural areas. While these successful initiatives directly assist small business owners and farmers in improving their business practices, the FY05 budget severely shortchanges these programs. As a result small farmers and companies will be unable expand their operations, and urban areas and rural towns will lose new economic development opportunities.

**Insufficiently Funding Entrepreneurial Development**

As large corporations have downsized, displaced workers have found new opportunities by launching their own small businesses. During the 1989-1993 recession, small firms created approximately 3.8 million jobs, far outpacing large firms. Over this period roughly 25 percent of downsized managers over the age of 40 started their own firms. Starting a small business is a difficult process and there are many barriers to success. To promote the creation of new small businesses and support their long-term success, the federal government offers a variety of entrepreneurial development programs. Through grants and direct assistance, these programs provide entrepreneurs the guidance needed to launch new companies, and the direction and resources needed for existing and emerging small businesses to continue to grow. Unfortunately, the FY05 budget for these programs is woefully inadequate.

**Small Manufacturers Struggle to Keep Pace**

Since President Bush took office the manufacturing sector has lost 2.7 million jobs, and many manufacturers are struggling to keep operations running. Unlike large corporations, small businesses do not have the resources to invest in cutting edge technologies that will allow their businesses to expand. Accordingly, the federal government developed programs which provide research and development assistance to small manufacturers. The Manufacturing Extension Partnership (MEP) program funds centers, which help small manufacturers adopt new technologies, processes and practices. In cutting funding for initatives like the MEP, the President's FY05 budget severely undermines small businesses' ability to compete with large manufacturers.

The FY05 budget contains significant cuts to small business programs. These cuts impact the full range of small business needs – including access to financing, resources to launch a company, support to spur economic development in underserved communities, and assistance for technological improvements. The priorities President Bush sets in his budget stand in stark contrast to the needs of our of nation's small businesses, and disregard the critical role entrepreneurs play in generating economic growth.

## Energy

Small business owners in virtually every sector of our economy are currently experiencing difficulties accessing affordable energy sources. Small trucking companies, landscapers, delivery businesses, and numerous other entrepreneurs are struggling to survive months of record gas prices, and even more small business owners are bracing for natural gas price increases that are expected to continue throughout the upcoming winter. The growth and development of our nation's small businesses owners depends on an effective national energy policy -- but unfortunately, desperately needed reforms failed to advance during the 108th Congress.

**Republican Energy Bill Fails Small Businesses**

In fact, the administration's proposal, the ***Energy Policy Act (H.R. 6)***, included numerous proposals that would have harmed small businesses, instead of providing relief. One provision would have granted a higher rate of return to electric utilities, which would have likely increased electricity rates for all small businesses throughout the country. The bill also included a repeal of the Public Utility Holding Company Act (PUHCA), which has long been sought by utility companies seeking to expand into these markets. PUHCA protects small businesses by preventing monopoly ownership of electricity production and ensuring that consumers do not end up paying for the bad investments of the utility industry. Repealing PUCHA without establishing adequate protections would have placed small companies at greater risk to devastating price hikes.

One-half to one-third of all energy is wasted through inefficiency. This is especially true for many small businesses that are high consumers of energy, including restaurants, groceries, convenience stores, laundries, bakeries, and small manufactures. H.R. 6 provided no direct funding to small businesses to implement or install energy efficient technologies, but contained billions of dollars of direct funding windfalls and subsides to large energy corporations. The bill also failed to adequately fund energy efficiency research and development (R&D) that would help small businesses utilize new energy saving technologies, but instead authorized almost $3 billion for R&D that would benefit large oil and coal industries.

The massive Northeast power outage was felt from Massachusetts to Michigan, as many small businesses struggled to restart their operations and recover from revenue losses. However, Congress has yet to produce a tough, seamless federal regulatory system that would prevent electricity companies from overloading transmission grids – which most involved would agree is the most pressing need after the blackout. As a result, our economy and small business owners remain vulnerable to future power outages.

The failed Republican energy policies would have increased costs for small business, placed them at greater risk to price-gouging and corporate fraud, weakened critical reliability protections, shortchanged investment in needed energy efficient technologies, and benefited large corporations at the expense of small companies. While many small business owners are thankful that this bill was not enacted, they are still seeking desperately needed reforms that are critical to the success of their businesses.

**Small Businesses Struggling with Rising Gas Prices**

The administration has made no progress reining in rising gasoline prices. Crude oil prices have topped record levels, exceeding $50 per barrel. Economists predict that these high energy costs will reduce the nation's gross domestic product by a full percentage point next year. Facing high energy costs, small business owners will be forced to raise prices or reduce costs, including cutting employee benefits and laying-off workers. Other companies, who barely survived expensive energy prices throughout the summer, will simply not be able to handle fall and winter increases, and will be forced to close their doors.

Small businesses tend to have little cash reserves, and operate on the tightest budgets. They consume half of the energy used in the U.S., and are disproportionately affected by price increases and policy failures. In the face of rising prices, small business owners have called for an energy policy that ensures access to secure supplies of clean, affordable energy sources so their companies continue to thrive and contribute to our nation's economy. Unfortunately, the Republican leadership has failed to meet the energy needs of U.S. small businesses, which will have serious consequences for their economic future.

## Federal Contracting

The federal government is the largest buyer in the world. In 2003, the government set a new record in purchasing at $285 billion. If contracts performed overseas are included, this figure rises to $300 billion – an increase of nearly 30 percent in government buying in one year, and an increase of nearly $100 billion since 2000. The government buys everything from food to computer software to construction services. One of the best ways for a small business to grow is to have the federal government as a customer.

Unfortunately, the federal marketplace continues to be closed to small businesses. For the fourth year in a row, the federal government's small business goals were not achieved. The federal government now contracts more than 77 percent of its work with just 3 percent of businesses. In fact, the top ten largest Department of Defense (DoD) contractors – the biggest buying agency – now receive 50 percent of all DoD contracts.

**Structural Changes Needed to Bring Equity to the Federal Marketplace**

One of the primary reasons for the failure of agencies to accomplish their small business goals is the creation of mega contracts. Contracts that could be performed by small firms are combined into giant contracts that are too large for small businesses to perform. From 1991 to 2000, the number of small business contract opportunities declined by 56 percent in large part due to contract bundling.

Numerous times in the past year, the President has made strong public statements regarding the need to ensure that small businesses receive access to the federal marketplace. Instead of matching the rhetoric with strong initiatives to curb the creation of giant contracts, the administration implemented a plan that will further decrease the ability of small businesses to access federal contracts. Rather than accomplishing the intended purpose of breaking up big contracts so that small firms can compete for the work, the administration's proposal actually decreases small business protections. Further, the plan does not contain measurements to evaluate its impact.

During the 108th Congress, the Committee on Small Business took the most dramatic steps to enhance the ability of small businesses to penetrate the federal marketplace since the late 1980s. ***The Small Business Reauthorization and Manufacturing Revitalization Act of 2003 (H.R. 2802)*** fixed structural flaws in the SBA's government contracting programs and increased the resources that the SBA has to enforce contracting laws, thereby ensuring an advocate for small businesses in the federal marketplace. Simply put, this legislation substantially increased the number of contract opportunities available to small companies.

Unfortunately, the Republican majority has yet to bring H.R. 2802 to the House floor for an up or down vote. Instead of embracing this bipartisan bill, the Republican leadership has spent the last year blocking this legislation that would have opened up the federal marketplace for small companies.

**Unfair Competition for Small Businesses**

For many years, small businesses have expressed concerns regarding the anti-competitive practices of the government-owned Federal Prison Industries (FPI). It is universally expressed by small business organizations as a top concern impacting the ability of small companies to compete fairly for government contracts. While the House passed the ***Federal Prison Industries Competition in Contracting Act (H.R. 1829)*** last fall, no further action has been taken. Attempts have been made that may ultimately prove successful to allow small businesses to directly compete against FPI; but unfortunately nothing has been done to address FPI's inherent competitive edge. These advantages include the ability of FPI to borrow working capital funds directly from the U.S. Treasury, and FPI's payment of mere pennies to its inmate workforce. Small businesses must rely on traditional financing options and must pay the prevailing wage to their employees on government contracts. As a result, when competing directly with FPI, small businesses are at a distinct disadvantage and will remain so unless changes are implemented.

**Fewer Protections for Subcontractors**

As the federal marketplace soars to record dollar levels, it would follow that small business opportunities would also increase. Unfortunately, this is not the case. In FY03, most of the federal agencies with the highest contracting volume saw lower numbers of small business opportunities than in FY02. Clearly, small business prime contracting opportunities are decreasing.

Because federal contracts have become larger through the propensity of federal agencies to combine small business contracts, subcontracting is the only option for many small companies interested in doing business with the government. The ***Subcontractor Protection Act (H.R. 1217)*** would require agencies to assess penalties if small disadvantaged business goals were not achieved. It would also increase protections to ensure small firms are not easily replaced as subcontractors once a contract is awarded. This proposal recognizes the lack of protections available to small business subcontractors, and yet it did not receive action in the 108th Congress. This bill would be a start by ensuring that small businesses are not easily replaced and enforces small business subcontracting goals.

**<u>Key Small Business Programs Remain Neglected</u>**
Despite the growing number of minority-owned companies in the United States, there continues to be a gap between the number of businesses and their participation in government contracts. These businesses represent 15 percent of all companies. However, the 5 percent small disadvantaged business goal established 16 years ago has not been accomplished for four years. Minority-owned companies received 3.54 percent of the government's contracts in fiscal year 2003. This failure cost small disadvantaged businesses $4 billion in federal contracting opportunities. Substantive changes to modernize programs designed to increase the role of minority-owned businesses in the federal marketplace were proposed in the 108th Congress. These changes represented the most significant modifications to these programs in nearly 20 years.

Nearly 7 million women entrepreneurs own the majority of their companies. These firms represent nearly 30 percent of all business owners. But, the 5 percent goal established 10 years ago has never been achieved. A women's procurement program was created in 2000 to address this problem, but it has yet to be implemented by the administration.

Full and fair small business participation in government contracting is crucial. Small firms provide exceptional quality at reasonable prices. The absence of small companies in the federal marketplace will cause prices to rise and quality to fall. Taxpayers deserve to have their valuable dollars wisely spent. To this end, increasing opportunities in federal contracts for small firms will continue to be an important focus. Overall, small businesses during the 108th Congress received little assistance in opening the federal marketplace, and saw their opportunities to compete for government contracts diminish.

## Health Care
The rising cost of health insurance is the number one concern for small businesses in the United States. A 2004 report by the Kaiser Family Foundation paints a bleak picture about the ability of small firms to afford health care for their employees. For the fourth straight year, health insurance costs for small employers increased by double digits, resulting in a sixty percent rise in premiums since 2000.

The dramatic increase in health insurance premiums over the last four years has forced many entrepreneurs to either drop coverage or reduce the type of coverage offered to their employees. The Kaiser Family Foundation report found that workers receiving health care from their employer fell from 65 percent in 2001 to 61 percent in 2004. And while the percentage of large firms offering coverage increased to 99 percent, the number of small firms (3-199 employees) offering coverage dropped to a five year low of 63 percent.

The small group market has been particularly subject to increasing premiums because many state insurance markets have three or few insurers. Whereas larger firms can self insure rather than purchase health care coverage from insurance companies, the lack of competition and increasing monopolistic power of insurers has caused rates to rise for small firms and will continue to climb for the foreseeable future. These small businesses lack the leverage in which to negotiate premiums, and are being hit with price increases every year.

**Failure to Act on Needed Health Care Reform**

Despite the clear need for reform, there has been no action to bring down these insurance costs. There have been no efforts to address the monopolistic power of insurance companies who are dictating prices to small firms. Nothing has been done to increase the options for small firms, increase competition in the state group market, or rein in the rising costs of prescription drugs. These failures have created a bleak picture for the future of small businesses who wish to start offering or maintaining their health insurance plans.

Democrats have worked on major health care proposals that would address the particular needs of small employers. The ***Small Business Health Insurance Promotion Act (H.R. 5346)*** would provide a tax credit for small businesses to defray the costs of health coverage. The bill also creates state and national multi-insurer pools to provide comprehensive and affordable health insurance choices to small employers and the self-employed, regardless of whether they receive the credit. This has been blocked by the Republican leadership.

Additionally, legislation such as the ***Small Business Health Insurance Affordability Act of 2003 (H.R. 1937)*** would increase the options of small businesses by allowing them to buy into the Federal Employees Health Benefits Plan (FEHBP). It has also stalled. These proposals are not designed to solve every problem in the health care market but will work to increase competition and allow small firms to take advantage of economies of scale and bargaining like large employers. However, it appears the needs of small business cannot overcome the interests of the insurance industry.

The administration has tried to tout, as its solution for the small business health care problem, the enactment of Association Health Plans (AHPs). The AHP concept has been around for nearly a decade, but while the ***Small Business Health Fairness Act of 2003 (H.R. 660)*** has passed the House in the 108th Congress, the President has yet to even secure a hearing on the issue in the Senate. These plans would target small businesses so they would be able to band together to purchase health insurance in a similar manner to that of large corporations. Since 2001, the president has talked about enacting AHP legislation but it has not moved any closer to enactment.

**Self Employed Lack Affordable Health Care Options**

The self-employed are a group of small businesses that have been particularly vulnerable to the rising health insurance costs. Those purchasing health insurance in the individual market are often expected to pay up to twenty to thirty percent more for health insurance. The lack of bargaining power for the self employed means they have little power to negotiate the premiums they pay from year to year. Many live in fear of a family illness because they know it means an insurer could drop their coverage or charge exorbitant rates when they need to renew their policies.

The ***Self-Employed Health Care Affordability Act of 2003 (H.R. 1873)*** is a bill that could help bring down health insurance costs for the self-employed. It is designed to make sure the self-employed can deduct health insurance costs in the same way that other businesses – both large and small – already can. This bill has a minimal budget cost that would put the self-employed on the same playing field as other businesses and would likely reduce the number of uninsured in this country.

**Health Care Costs Reduce America's Small Firm Competitiveness**

While the call for action by small businesses has been clear, the follow-up on the legislative front has been less than successful. Legislation has been introduced in both chambers that would target small business health care costs, but has failed to receive the full backing of the administration. As a result, it appears that the $108^{th}$ Congress will fail to move any initiatives that would control the costs of health care.

The rising costs of health care insurance have made it more difficult for America's small firms to survive and compete in a global economy. They cannot compete against large firms who have the ability to reduce health care costs by self-insuring and avoiding the insurance companies who are gouging small businesses. They cannot compete against foreign competitors – many who do not even offer health care coverage – because they must spend so much on health care as opposed to research or purchasing new equipment. These rising costs have reached a crisis level over the last four years, but there has been no congressional action to address it.

A sound economic policy must address these rising costs. By bringing down health care costs, it will allow small businesses to hire and expand, and invest those monies back into their business. Unfortunately, this administration has tried to pacify the small business community by talking about helping small businesses without providing any actual relief.

## Pension Reform

Retirement plan coverage is one of the tools that small employers use to recruit and maintain their workforce. In order to attract quality employees, small businesses must be able to offer comprehensive retirement plan coverage. Unfortunately, the issue of retirement coverage for small businesses has not been a priority in the $108^{th}$ Congress.

Our retirement system is designed like many of our laws – with a one-size fits all approach. Small firms do not have human resources departments to manage the complex rules required to run a retirement plan. While there has been gradual recognition of this problem, the failure to design quality retirement options for small firms has created the enormous "pension gap" in this country. It is estimated that less than one-third of employers working for firms with fewer than 25 employees are covered by a retirement plan, and only about one-half of employees working with firms between 25-99 people are covered. In comparison, over 80 percent of employers with over 100 employees are covered by a plan.

**Current System Hinders Small Business Retirement Coverage**

The current tax code and complex reporting requirements make it extremely expensive for small businesses to set up and operate retirement plans for its employees. The rules for offering a plan are catered to large corporations and unfairly prevent small employers and their employees from taking full advantage of the benefits of these plans.

Solutions need to be put in place that will not only encourage small firms to offer coverage, but provide them the tools to run and operate a plan. Instead, the high costs associated with operating a plan block many small firms from ever offering a plan. Expanding the tax credit for set up costs is one way to address this problem for small businesses. Also, recognizing that the needs of small businesses and their employees may be different than their corporate competitors could move us closer to a solution.

The creation of the SIMPLE (Savings Incentive Match Plan for Employee) plan was clearly a step forward, as it was meant to target small businesses. Building on this concept, so that the tax benefits of small businesses are in line with those of corporate plans, will also help. It can be a delicate balance as Congress wants to encourage retirement coverage while preventing the abuses of these plans to provide a benefit to only a few.

**Straightforward Legislation would meet Small Business Needs**

The ***Pension Preservation and Savings Expansion Act of 2003 (H.R. 1776)*** is a bipartisan bill that would provide necessary changes to the current retirement plan system. This legislation would reduce the inequities and create greater incentives for small firms to offer retirement coverage. It would expand the savings opportunities for small employer plans and reduce complexities for firms that set up a plan.

***H.R. 1776*** recognizes that there is a discrepancy in the way we treat our large employers versus our small employers when it comes to pensions. This bill would provide safeguards to protect employees while improving the retirement plan options for small employers. It would help clarify reporting requirements for small and large employer plans – a significant detractor for small firms who want to set up a plan. It would also increase the tax advantages for SIMPLE (generally used by small businesses) plans to bring them closer in line with the benefits of a large employer plan. Instead of moving this legislation, the issue of retirement security for small firms has been bypassed. While the legislation has been reported out of committee, it has failed to reach the House floor for a vote despite support from both sides of the aisle.

**Pension Reform is Important for Small Firms to Compete**

It is unfortunate that these needs have been pushed aside despite their importance and minimal budget impact. The differences in tax advantages between large and small employer plans have created a competitive disadvantage in the ability of entrepreneurs to recruit employees. The gap in the contribution limits between large and small employer plans also increases the gap in participation rates. The "pension gap" hurts small employers and it means that many of their employees may not have the nest egg in place when they retire.

Employer retirement plans have a proven track of improving savings for employees who will see more benefit from their job. As a result, the abysmal savings rate in the United States is only further exacerbated by the failure to meet the needs of small businesses in the 108th Congress. Unfortunately, the changes over the last four years have focused on large firm plans.

## Regulatory and Paperwork Burden

Every new regulation or government form places a disproportionately large burden on small business owners. Complying with regulations is a costly problem for small business that drains money away from operations, reduces the capacity to hire more workers and places them at disadvantage with foreign and domestic competitors. Despite assertions by the administration and House Leadership that reducing the burden on small business was a top priority, federal regulations and paperwork remain a growing problem.

**Regulatory Burden Is a Serious Problem for Small Businesses**

The federal paperwork burden continues to be one of their most significant problems facing small businesses. A recent study by the SBA's Office of Advocacy estimated that complying with federal regulations and paperwork costs businesses and individuals $843 billion each year.

Burdensome regulations affect the ability of small business to compete in today's global marketplace. The same SBA study showed that small businesses pay 60 percent more to comply with government regulations than their larger competitors, creating a significant hardship. Further, a 2003 Treasury Department analysis of compliance costs found that self-employed business owners filed about 25 percent of all individual tax returns, but paid about 60 percent of the overall cost of tax compliance.

**Promises Unfulfilled**

President Bush and the Republican leadership repeatedly pledged to reduce federal regulations and paperwork, and included it as a top priority in the President's Small Business Agenda and Six Point Plan for Economic Recovery. Unfortunately, for small business, the reality has not matched his rhetoric and the burden is increasing at a record pace. Despite congressionally mandated reductions for federal agencies, the GAO recently found that federal paperwork has increased in each of the last 4 years. Last year, federal agencies issued 2,300 new proposed rules, and have published over a quarter million pages of regulatory proposals, notices, and rulings since 2001. According to OMB, in 2002 the Bush Administration's legislative and regulatory proposals increased paperwork more than any previous year in history. This increase in regulations and paperwork severely hinders the ability of small business to expand and limits economic growth. During the 108th Congress, a number of proposals were introduced to address the regulatory problems facing small businesses. However, none of these initiatives were approved.

**Improving the System That Oversees Paperwork and Regulations**

Hearings by the House Small Business Committee and the Government Affairs Committee focused on shortfalls in federal government programs designed to reduce regulations and paperwork. For example, the Office of Information and Regulatory Assistance (OIRA) is charged with ensuring that unnecessary and overly burdensome regulations are not implemented. However, OIRA lacks the resources needed to thoroughly review all of the IRS requests to collect paperwork and the thousands of forms the agency publishes each year. The ***Paperwork and Regulatory Improvements Act of 2003*** (***H.R. 2432*** – subsequently incorporated into ***H.R. 2728***) sought to address a number of obstacles that prevent federal agencies from concentrating on reducing these federal burdens. For example, the bill originally would have required the OIRA to double the amount of analysts reviewing IRS paperwork requests. The bill passed the House but died in the Senate, leaving the problems of burdensome tax reporting and agency paperwork unresolved.

It is more important than ever that proposed regulations be reviewed carefully to avoid unintended consequences. The Regulatory Flexibility Act, the foundation for small business regulatory review efforts, was enacted in 1980 to ensure that federal agencies take into account the impact that regulations have on small businesses. However, a series of reports and oversight hearings have demonstrated that agencies are still not meeting the requirements of RFA, which is costing small businesses billion of dollars each year. The ***Regulatory Flexibility Improvement Act (H.R. 2345)*** seeks to specify the economic impacts on small businesses that agencies must examine. It provides greater detail for the criteria used in agency analysis; requires IRS and other agencies to open up their regulation writing system to earlier and more effective small business participation, and eliminates barriers to judicial review once a final rule is published. Small business groups across the board have recommended that the Regulatory Flexibility Act be improved. However, the Republican Leadership refused to advance any of the needed reforms during the 108th Congress.

**Enabling Small Business to Insist On Their Rights**

All too often, it is easier and cheaper for a small business to accept an unjust federal penalty than pay the costs to fight it. In passing the Equal Access to Justice Act 25 years ago, Congress recognized that many small businesses cannot afford the legal costs of defending themselves when disputes with federal agencies arise. The ***Equal Access to Justice Reform Act*** (EAJRA) ***(H.R. 2282)*** was introduced to tighten the law and close the loopholes that have limited the effectiveness of its provisions in protecting our nation's small businesses. Neither the Judiciary Committee nor the Small Business Committee held hearings, nor did the House leadership make any effort to move this important bill.

**Organizing The Exchange Of Information**

Small businesses need help in knowing how to comply with thousands of laws and regulations applied to them each year. The ***Small Business Paperwork Relief Act of 2002*** was enacted in the 107th Congress to ensure that federal agencies do a better job of communicating with small businesses. It required the OMB to publish a list of all compliance assistance resources available to small businesses and compel each agency to establish one point of contact to act as a liaison with small firms for paperwork requirements. The OMB was also to create a task force made up of representatives from key agencies to make recommendation to develop an interactive Government-wide website that would help facilitate small business compliance. Unfortunately, oversight hearings have revealed that agencies have not fully implemented numerous provisions of this bill – including failing to publish compliance materials, and establish points of contact, and the "interagency task force" has failed to make any real progress in launching the website.

**Cushioning the Paperwork Blow For Small Business**

Finally, in the years since enactment of the ***Small Business Regulatory Enforcement Fairness Act (1996 SBREFA)*** and its follow-up bill, the Small Business Paperwork Relief Act, federal agencies were supposed to create a system to reduce or eliminate penalties for small businesses for 'first time' violations of laws, regulations and paperwork requirements in certain, non-harmful circumstances. The idea was to reduce the punishment aspect of the law and focus more on helping small business through education. The agencies were to record their enforcement actions against small businesses to see how well they were implementing the first offense reductions and waiver policies as instructed by the SBREFA law. However, the administration has failed to fully comply with the law, and efforts to reduce the burden on small business are falling far short.

Another bill with a similar intent, the ***Small Business Paperwork Amnesty Act (H.R. 1867)*** would have eliminated civil fines for small business first time offenders. For certain types of cases (non-criminal, not impairing health and safety, non-tax) that were remedied within 6 months, the civil penalty would be removed. The bill would have written into the law the enforcement relief provisions that agencies were supposed to be establishing by policy. Unfortunately, none of these proposals advanced during the 108th Congress.

**An Independent Office of Advocacy – Help in Reviewing Regulations**

Small businesses lack the time and resources to participate effectively in these federal policy discussions. In 1976, Congress recognized the problem and created the Office of Advocacy at SBA headed by a Chief Counsel appointed by the president. His mission is to ensure small businesses are incorporated into all aspects of federal policymaking.

The Office has had solid success, saving billions of dollars by objecting to duplicative or improvement regulations, researching legislation, and gathering data to inform the government of small business problems. Advocacy's regulatory work constantly challenges powerful federal agencies when the interests of small business are at stake. Congress authorized key tools for Advocacy to help assure some level of autonomy. Advocacy is allowed to submit reports, correspondence and testimony directly to Congress or federal agencies without prior clearance through the White House. Also, the Office of Advocacy monitors agency compliance with the Regulatory Flexibility Act (RFA) that requires agencies to give consideration to the impact of their actions on small business and consider less burdensome alternatives. In addition, Congress granted the Chief Counsel specific authority to join federal court cases involving the RFA without the usual consent from the Justice Department.

However, the structure of the Office of Advocacy's budget limits it independence. The bulk of Advocacy's budget flows through SBA and is reviewed by OMB, two agencies Advocacy sometimes must criticize with regard to regulatory matters. This leaves Advocacy vulnerable to funding reductions when it does not agree with these agencies. Early in the 108th Congress, the House passed H.R. 1772, to ensure Advocacy's independence. Despite promises by both the House and Senate leadership, Congress failed to take steps to ensure the autonomy of the Office of Advocacy.

Regulations are necessary for public health and safety, and the enforcement of fair competition. However, small businesses deserve the least intrusive regulations possible. There are good proposals on the table that would sharpen the tools that protect small businesses from over-reaching federal agencies, such as the Regulatory Flexibility Act or Independence for the Office of Advocacy. While professing to make burden reduction a top priority, the numbers of regulations has grown dramatically under the Bush administration. U.S. businesses cannot expand and create jobs when they are overburdened with regulations and paperwork from federal agencies. More should have been done during the 108th Congress to resolve concerns.

## Tax Relief and Simplification

A major issue that has been debated by this Congress is providing tax relief and tax simplification for our nation's small businesses. Unfortunately, while there has been a great amount of discussion about achieving these initiatives, there has been little action. In the 108th Congress, there have been two major tax bills with a total cost of $496 billion that have provided little in terms of actual relief and only increased complexity in the tax code for entrepreneurs.

When dealing with small businesses, altering our tax code by providing tax incentives can encourage investing back into the business, hiring of new employees, and offering employee benefits such as health care. Many view tax relief that is targeted towards small businesses as being more effective as a stimulus because these firms are more flexible and can more rapidly change. They can also provide a greater return because of their proven track record of creating jobs. Targeted tax relief for small businesses can be part of a sound economic policy, as these firms are often responsible for creating jobs as a direct result of these incentives.

The approach ultimately taken has been focused more on applying relief to sectors of the economy other than small businesses. It appears that the economic debate in the 108th Congress, as well as the 107th Congress, was dominated by the belief that tax incentives should go toward larger, established firms. A breakdown of the tax bills over that period show that these tax cuts provided little relief to small firms, while only increasing the deficit. This was likely a contributor in the woeful job creation numbers during that time. These economic decisions were made despite clear solutions that would have stimulated the small business sector.

**<u>Small Firms Waiting for Targeted Tax Relief</u>**

Two of the highest priorities for small businesses were extending the bonus depreciation and permanent increased equipment expensing under Section 179 of the tax code. These measures are important because they reward firms that invest in their business, especially at a time when the economic outlook is less than certain. For many small business owners, the greatest concern about making large investments is that they will drain their cash flow. Section 179 expensing allows small firms to immediately write off the cost of large equipment purchases and receive a tax benefit in the year they purchase it. Bonus depreciation similarly allows them to write off certain businesses in the year of purchase and is designed to be a stimulus for investment.

***Small Business Expensing Permanency Act of 2003 (H.R. 2368)*** and ***Bonus Depreciation Extension 2004*** **(*H.R. 4128)*** were two bills that were designed to extend these measures. However, instead of providing small firms with certainty by adopting these tax incentives for more than a year, the 2003 tax cut sunset the bonus depreciation after one year and the Section 179 expensing after only two years. Small business concerns were squeezed out in favor of a dividend tax cuts that benefited large corporations and made up nearly half the cost of the bill. As a result, a company with a five-year business plan simply cannot make informed decisions when two of the provisions aimed at small businesses expire after only one and two years.

The lack of targeted tax relief for small businesses in the 108th Congress has been remarkable, both in amount and in comparison to the relief aimed at their corporate counterparts. Rather than providing actual small businesses tax relief, it has been rationalized that the top marginal rate cuts provided the greatest benefit to small business owners. Given that less than 1 percent of small business owners are in the top tax bracket, this clearly does little to provide any benefit. In fact, over half of small business owner saw less than $500 under the 2003 tax bill. This is despite the fact there were clear small firm initiatives that could have been included in this $350 billion tax bill that were left out.

**<u>AMT: A Looming Problem for Small Business Owners</u>**

The Alternative Minimum Tax (AMT) is another problem that continues to loom over small business owners due to this Congress' inaction. The AMT was originally designed to prevent wealthy Americans from avoiding taxes, but instead has ensnared many middle income and small business owners. Entrepreneurs are particularly vulnerable to the AMT because of the variety of deductions they take when calculating their income taxes. Calculating the AMT is a complicated matter that even the most seasoned tax experts have difficulty in determining.

Legislation like the ***Alternative Minimum Tax Repeal Act of 2004 (H.R. 4131)*** would remedy this problem. Unfortunately, rather than addressing this issue in the four tax cuts in four years, it continues to be a problem that has actually been exacerbated by the marginal rate cuts. While approximately two million individuals are now subject to the AMT, this number could reach 35 million by 2010, according to the Urban Institute. The failure to address it means that thousands of small business owners will be spending their resources on preparing and dealing with the complicated effects of the AMT.

The AMT problem prevents small business owners from effectively planning for their tax liability and spending more on tax preparation. Small business owners cannot be expected to determine what business decisions will effectively increase their liability under the AMT. Unfortunately, the likelihood that the AMT will be adequately addressed in the future is hurt by the fact that the government is already running a $450 billion deficit.

## Tax Code Grows More Complicated

The 108th Congress was clearly a failure in its efforts to simplify the tax code for small businesses. It failed to accomplish the goal of reducing the increasing burdens of tax preparation and compliance on small business owners. Even the administration's economic advisers in a recently unearthed memo, noted that the "tax system [has] grown needlessly complex, economically inefficient, unpredictable and unfair." While this is a widely recognized problem, there were no significant efforts to address it.

The ***Small Business Tax Simplification Act of 2003 (H.R. 22)*** was a low cost proposal that would have simplified the complicated organization rules for small business. While large corporations are generally organized as C Corporation, small firms must decide many types of incorporation that affect their taxes as well as their liability. H.R. 22 was designed to clarify the types of options available, as well as the rules that govern them.

***The Small Business Tax Fairness Act of 2003 (H.R. 1126)*** was another bill that was touted as addressing some problems that would have streamlined the way small businesses prepare the taxes while reducing their current liabilities. It addressed and clarified a number of depreciation schedules for different business types as well as providing Section 179 expensing tax relief. As with most other small business bills, it failed to advance. The tax cuts could have included a number of these measures, but they were not deemed priorities.

## More Tax Cuts, Less Relief

The beginning of the 108th Congress was to mark the year that small business' needs were put at the top of the priority list. The 2001 and 2002 tax cuts had a cost of nearly $2 trillion but less than five percent was in the form of targeted tax cuts for small businesses. Unfortunately, while a $350 billion tax cut was passed in 2003 and a $149 billion cut enacted in 2004, small firms again saw little relief. Rather than providing relief, many small firms are confronted with a more complicated tax code with more forms than they had two years ago. They are also faced with the prospect that their economic growth could be choked off by an exploding federal deficit leading to higher interest rates.

The failure to provide small business relief means that entrepreneurs will not have the incentive to re-invest and expand their businesses. These failures will stifle innovation expansion meaning that this country will continue to see continued weak economic growth and a lack of job growth. It is unfortunate that this Congress will go down with promising the most for small business, but delivering the least.

## Technology

Technology is one of the most important issues facing small businesses. It allows small businesses to more easily compete against their larger competitors. Small firms have been entering the world of electronic commerce in large numbers – both as beneficiaries and as developers of systems that are revolutionizing business practices. Unfortunately, small IT companies continue to face obstacles, and mainstream small businesses continue to be unable to access the necessary technologies to compete in today's marketplace.

### Small Business Technology Costs

A significant barrier to small business access to technology is cost. It is estimated that the initial investment in an e-commerce web site is $10,000, with annual maintenance and support costing $2,000. Any assistance to reduce these costs would help small companies compete. While the House passed ***H.R. 49, the Internet Tax Nondiscrimination Act***, which permanently prohibits taxes on Internet access, the bill has never been enacted into law. Other measures that would have extended the ban also failed to advance during the 108th Congress.

While the Republican Leadership has expressed support for a permanent moratorium, enacting legislation was clearly not a priority. Meanwhile, small businesses are subject to expensive Internet-related costs, with little hope of relief. It has been argued that the failure to extend the tax ban will overburden small companies and consumers with innumerable fees amounting to billions of dollars. Moreover, additional Internet-related taxes are seen by many as placing higher taxes on Internet sales, treating them differently than brick-and-mortar sales. As most small business on-line transactions are through business-to-business electronic commerce, these types of taxes hit small firms hard. Small businesses already operate on the tightest budgets, and any additional Internet costs present a serious burden for these companies.

### Availability of High-Speed Internet Access

In order for small businesses to compete effectively with their large business counterparts in today's global marketplace, small firms must have access to high-speed Internet technology. In 2002, on-line retail sales accounted for $44 billion – up from $15 billion in 1999. Unfortunately, while 60 percent of small businesses have web sites, only 35 percent sell on-line. Small businesses are clearly not keeping pace with their large business counterparts in the use of technology to increase sales. Both costs of selling on-line and availability of broadband access contribute to this divide.

A solution to encourage broadband build-out was ***H.R. 768, the Broadband Internet Tax Credit***. This bill proposes tax incentives through expensing to both broadband providers and businesses to offset the costs of broadband equipment. The failure to enact initiatives to ensure broadband deployment threatens the ability of small businesses to remain competitive in electronic commerce.

Nowhere in this country are small companies more behind than low-income areas in-so-far as high-speed Internet access. Unfortunately, less than 5 percent of customers in areas with populations under 10,000 have broadband Internet capabilities. ***H.R. 4699*** attempts to address this gap. The legislation provides grants to support broadband economic development efforts in rural and low-income areas. Small businesses continue to be the primary job creators, employing three-quarters of the workforce. In order to allow small businesses to relieve the economic downturn that under-served areas are still recovering from, these companies must be given the tools to expand. Broadband Internet access is one of those tools. Without legislative initiatives that deploy these technologies to all areas of the country, the economic gap will continue to grow.

**Making Capital More Available To High-Tech Companies**

Small high-tech companies have faced many challenges – most notably the economic malaise that has blanketed the U.S. for much of the past four years. These challenges are evident in the severe job losses that have plagued the high-tech industry as more than 400,000 jobs have been lost between March 2001 and April 2004. Despite these recent struggles, small high-tech companies are a catalyst for innovation and invention, producing 13 to 14 times more patents per employee than their large business counterparts.

In the 2nd quarter of 2004, the U.S. venture capital industry invested close to $6 billion in nearly 800 high-tech companies. However, strict interpretation of a key federal research and development program's guidelines has and will continue to prevent the most innovative venture-backed small companies in the United States from accessing the funds they need to grow.

During the 108th Congress, ***H.R. 4149*** and ***S. 2384*** were introduced to allow venture-backed high-tech companies to fully participate in federal research and development programs, permitting these firms to access the capital they need to expand and create new jobs. However, this legislation has been stalled, causing many small companies to go without this vital funding – and forcing many high-tech firms to delay research and development that could ultimately lead to the creation of new jobs and even new industries.

The growth of technology and the impact of the small business technology sector is of the utmost importance to this nation's economy. Technology makes the world a smaller place. By giving small businesses access to the tools necessary to make better use of technology, we are ensuring their role in the global economy. Small high tech companies are the innovators that bring new ideas to the marketplace. Both small high tech companies, and small businesses relying on technology, saw no legislative relief during the 108th Congress.

## Trade

As trade has become more important to the U.S. economy, it has also become increasingly important to our nation's small businesses. Small companies now represent 97 percent of all exporters. While foreign markets offer new opportunities for businesses exporting products, they also create increased competition for U.S. businesses supplying our domestic markets. As with the federal budget, the United States is currently running a massive trade deficit, reaching over $163 billion for the second quarter of 2004. With support from federal programs, small businesses can play a critical role in reducing our nation's trade deficit. These initiatives ensure that U.S. entrepreneurs have access to foreign markets, are competing on a level playing field, and are receiving the assistance and support they need to maximize all international trade opportunities.

**Trade Agreements Leave out Small Business Needs**

During the 108th Congress there was a substantial effort to enter into free trade agreements around the world. Unlike large corporations, small companies often lack the resources needed to explore the possibilities of international trade. Free trade agreements can reduce these barriers and open up new markets for U.S. small businesses. These agreements also give foreign companies increased access to our economy. This is a delicate balance that if tipped in the wrong direction can be especially devastating to small businesses, as they often operate on the tightest budgets.

The United States entered into free trade agreements with Chile, Singapore, Morocco and Australia during 108th Congress, and is currently negotiating with other countries. A key concern with the completed trade agreements signed by President Bush is that they do not fully level the playing field for U.S. small businesses. Under these free trade agreements, foreign competitors can take advantage of less stringent labor laws to substantially reduce costs and price U.S. companies out of the market. Previous trade agreements included protections to prevent these inequities. However, the free trade agreements signed during the 108th Congress did not provide small business exporters with the appropriate level of support required to ensure their success.

**Failure to Provide Small Business Assistance for the Global Marketplace**

Trade agreements can be detrimental to our nation's small businesses if they are unable to take advantage of foreign opportunities, at a time when overseas competitors gain access to U.S. markets. Trade agreements open up markets for small businesses, but they do not provide the assistance entrepreneurs need to make the most of these opportunities. However, funding for technical and financial assistance programs that help U.S. small businesses effectively compete in these new markets has been cut. U.S. Export Assistance Centers (USEACs) combine the services of the SBA, Department of Commerce, the U.S. Agency of International Development and the Export-Import Bank to provide a one-stop shop to address the exporting needs of small companies. Funding was cut for this program, as well as the Export-Import Bank, which provides loans to U.S. entrepreneurs seeking to enter the global market.

**Increasing Tariffs and Lack of FSC/ETI Relief Hinders Small Manufacturers**

There are a variety of measures that the United States can take to ensure that foreign countries are not implementing measures that place their businesses at an unfair advantage in the global market. U.S. small businesses are very concerned that foreign countries are manipulating their currencies in order to provide their businesses with this advantage. For example, China has pegged its currency to the value of the dollar -- which makes Chinese exports relatively inexpensive while increasing the prices of American imports to China. Despite evidence of currency manipulation by foreign nations, the administration failed to address this issue during the 108th Congress, leaving U.S. businesses open to international market manipulations.

The 108th Congress also created additional exporting barriers for our nation's entrepreneurs by failing to resolve Foreign Sales Corporation/ Extraterritorial Income (FSC-ETI) tax issues that led the European Union to impose duties on certain U.S. products. The majority of our exporting manufacturers are small businesses. The House approved H.R. 4520 to resolve the FSC-ETI issue and ensure that U.S. exporters receive tax relief. However, a study by the Joint Committee on Taxation found that fewer than 5 percent of our nation's manufacturers would receive any significant benefit under the bill. An alternative bill was offered by Rep. Crane (R-IL) and Rep. Rangel (D-NY) that would have focused on providing relief for small manufacturers. However, despite the fact that this alternative had the broad support of the business community, this legislation was ignored. During the 108th Congress the government has fallen short in standing up for small business in the global marketplace.

International trade offers a great opportunity for small businesses to enter new markets. Small businesses must be given the tools to fully access the global marketplace, or they will lose ground to their foreign competitors. Congress has shortchanged the export and financial assistance programs that small businesses need to succeed internationally, and has failed to ensure that the international playing field is level. Unless these failures are corrected, our nation's small businesses will be unable to fully reap the benefits of free trade, and will be driven out of domestic and global markets by foreign competition.

## Transportation/Infrastructure

Our nation's transportation infrastructure generates over $200 billion in economic activity in the US each year and sustains over 2 million jobs for American workers. Highway transportation comprises 15 percent of the US gross national product and 84 percent of all US spending on transportation. For every $1 billion that the federal government invests in road and transit construction, 47,500 new jobs are created -- and every $1 investment generates $6 in economic return. It is small businesses that dominate US transportation industries -- with contractors and architects, information technology engineers and equipment distributors, bus operators, truck drivers and travel agents, and other small firms working to plan, construct, maintain and utilize our roads, transit and rail system, ports, and waterways. Their survival and the financial security of the workers they employ, as well as the health of our national economy, depends on a transportation reauthorization bill that stalled during the 108th Congress.

***The Transportation Equity Act for the 21st Century (TEA-21)*** – the major six-year funding authorization bill for federal highway, highway safety, transit and other surface transportation programs – provides critical funding for major local transportation projects in communities across the country. These projects create opportunities for small business growth in construction, travel and tourism, and other industries, which in turn creates needed jobs for America's workforce, generates local economic development, and stimulates the US economy. TEA-21 expired on September 30, 2003.

Early this year, Democratic Members of the House Small Business Committee held a Transportation Roundtable which provided an opportunity to hear from the small companies that design, construct, and depend on our nation's transportation system. The goal of the roundtable was to ensure that small businesses were an integral part of congressional debate and negotiations on transportation reauthorization legislation. Through this partnership with key small business transportation associations, Committee Members have been pressuring the Congressional Leadership to enact a well-funded, long-term reauthorization bill.

However, instead of approving a bipartisan reauthorization bill that would have provided the funding needed to maintain and improve our nation's transportation system, the Bush Administration has insisted on legislation that would flat-fund these critical programs. Despite controlling the House, Senate and White House, the Republican Leadership was unable to garner enough support even within its own majority party to send this woefully underfunded measure to the President's desk.

Instead of working through stalled congressional negotiations to craft or enact bipartisan reauthorization legislation, the Republican Leadership disregarded the consequences for the transportation industry and repeatedly approved temporary extension measures. The six different stop-gap extension bills continued current funding levels for existing transportation programs, and provided no resources to initiate new transportation projects.

**GOP Failure to Enact a Six-year Bill Is Already Hurting Small Businesses**

Many small businesses are already feeling the impact of the delay in the reauthorization of TEA-21, as states are reluctant to plan projects until the bill and funding levels are finalized. Some small businesses are now facing worker lay-offs or even bankruptcy because of the lack of transportation projects in the pipeline caused by the legislative delay.

While larger companies can more easily absorb the impact of lay-offs, the consequences for small construction companies, equipment suppliers, engineering firms, and others are much more severe. Most small companies have no room for extra expenses, so each employee is essential to the business' operation. In the transportation industries, and especially for small firms that may specialize in a particular field, employers often must invest in training programs for their personnel. Consequently, when these small businesses are forced to lay-off employees they lose essential workers, as well as the costs invested in job training. Should these small businesses survive lay-offs and delays in transportation projects, they would then face the additional costs of recruiting and training new workers.

With each passing day our nation's transportation system becomes more outdated and less efficient, slowing the wheels of US commerce. Nationwide, congestion costs more than $67 billion annually -- more than 3.6 billion hours of delay and 5.7 billion gallons of excess fuel consumed. The average driver for a small trucking business, delivery service, or tour bus company is losing more than a week and a half of work sitting in gridlock each year. For small businesses struggling to maintain the bottom line, increased fuel costs, lost time and squandered economic opportunities can be catastrophic. To minimize costs and effectively compete with large companies, small businesses need a seamless and reliable transportation system.

Without a full six-year reauthorization to comprehensively address our current transportation and infrastructure demands, small businesses will continue to struggle. A six-year bill will alleviate congestion that cripples U.S. Commerce, and create significant opportunities for small business growth in construction, equipment sales, travel and tourism, and other industries – which in turn generates needed jobs for America's workforce and stimulates the economy. Investing in transportation and infrastructure will also promote economic development, enhance and expand industrial growth, and revitalize rural towns, smaller communities, and underserved urban areas. It is disheartening that the Republican Leadership has chosen to push-aside TEA-21 reauthorization until the next Congress, when investing in our nation's infrastructure and transportation system is so crucial to small business growth and our economic vitality.

## Small Business "Wins" That Provide No Small Business Relief

During the 108th Congress, several legislative initiatives and other measures were enacted that the Republican Congressional Leadership and the Bush administration touted as "wins" for small business. But a closer review of these so-called "wins" reveals that they have only a minor impact on small enterprise, while some actually provide substantial benefits to their large corporate competitors.

The most striking example is President Bush's Small Business Agenda. The President continues to profess the successes of this agenda with great fanfare to the nation's small business owners. This five part plan outlined his "top priorities" to help America's small business. However, the President has accomplished none of the key elements he targeted in his Small Business Agenda -- despite having the combined resources of the Executive Branch under his command and Republican majorities in the House and Senate.

***Provide new tax incentives to make it easier for small businesses to make important job-creating investments -*** The administration often champions its tax policies as a means to encourage small business investment and expansion. However, the supposed tax incentives provided by the President's tax cuts provided illusory benefits to small businesses.

President Bush has pronounced that the best way to help small firms reduce their tax burden is by reducing the individual marginal tax rates – particularly the top tax bracket. He has gone so far as to suggest that the primary beneficiaries of the marginal rate reductions in the tax cuts were small business owners. However, a dissection of Treasury statistics shows that the benefit promised to entrepreneurs is substantially inflated, and that these tax policies will do little to stimulate the small business sector.

In reality, the tax cuts, particularly the 2003 bill, will do more harm than relief to small firms. A close analysis of the 2003 tax cuts reveals that the failure to provide more targeted small business tax cuts while expanding the budget deficit will have a dampening effect on job growth in the small business sector. According to figures from Treasury and other government agencies, over half of small businesses received less than $500 under the bill. Not only did they receive little benefit, but small businesses are likely to face an even more difficult economic environment.

The soaring deficits created by these tax cuts are likely to drive up interest rates – reducing debt financing as an option for small firms. Small firms are already struggling to access capital because of the administration's lack of commitment to loan programs that meet their unique needs. Additionally, the dividend tax break included in the 2003 bill will further limit the ability of small businesses to obtain equity financing. The dividend tax cut will shift investment away from small businesses – who receive no benefit from the corporate tax break – toward large corporations that can pay these dividends. Given that less than 5 percent of this administration's 2003 tax cuts were in the form of targeted tax cuts for small businesses, it is clear their needs were not a priority.

***Give small business owners more power to provide health care for their uninsured employees, and improve the health care options for employees who already have insurance*** – During his term in office, the President has presided over double digit increases in health insurance premiums in each of his 4 years. Instead of focusing on real health reform, the President focused on Health Savings Accounts (HSAs). HSAs were created as part of the Medicare package in 2003 and are purported to drive down health care costs through consumer driven health care. An HSA is a tax deductible account that can be tapped to cover costs associated with a high deductible insurance policy. These are touted as offering a quality alternative to traditional low deductible health insurance offered by employers.

Unfortunately, HSA's will do nothing to bring down health care costs for small businesses and could actually increase health care costs. These savings accounts will encourage healthy individuals to pull out of traditional plans offered by small firms and segment the health insurance markets into sick and healthy populations. As a result, the firms and employees left in the traditional low deductible insurance plans – many times those with families – will see an increase in their health care costs. Instead of responding to the sixty percent premium jump that occurred during his watch, President Bush pushed a tax shelter that offers no relief to skyrocketing prices, and will likely drive up the costs for small companies. Small businesses need comprehensive changes to our health care system, not gimmicks that do nothing to solve the problem.

***Tear down the regulatory barriers to job creation and give small business owners a voice in complex and confusing regulatory process*** – The burden of federal regulations remains one of the most expensive problems facing small businesses. Yet during the Bush Administration 250,000 pages were added to the Federal Register and 720,000 million more hours are required each year to complete government paperwork. Last year alone, agencies filed 2,300 new proposed rules.

***Save taxpayer dollars by ensuring full and open competition to government contracts* –** During the 4 years of the Bush Presidency, the federal government has never met its goals for small business prime contracting, minority business contracting or women-owned business contracting. In spite of a so-called solution, contract bundling remains the most commonly mentioned complaint by small businesses because the federal employees charged with enforcing bundling rules have no real authority.

***Provide small businesses with the information they need to succeed*** – Although some federal Internet pages are very helpful to small businesses most of the best ones were already outstanding sites before the President took office. Most sites are confusing for small businesses and information is difficult for small businesses to use. A number of its large projects have either been shelved or are still inching through the pilot stage. The projects implementing requirements at each federal agency to publish small business compliance guides and establish small business points of contact are all way behind schedule.

## Conclusion

At the beginning of the $108^{th}$ Congress, small businesses were prominently incorporated into the agendas put forth by both the Bush Administration and the House Republican Leadership. Now, after two years and two legislative sessions, this Congress is coming to a close. With promises of significant progress and assurances of success, the lack of accomplishments in addressing the needs of our nation's small businesses during this Congress is especially striking.

As this report highlights, none of the 11 key issues reviewed in this report, including the proposals from President Bush's Small Business Agenda, were resolved during the $108^{th}$ Congress. These policy failures range from implementing tax breaks that offer little, if any, relief to small businesses; failing to bring down health care costs; and abandoning efforts to implement energy and transportation legislation critical to small business growth. In reviewing the 11 items, nothing got done.

Not only was progress not achieved on these critical issues, in many areas the situation has actually grown significantly worse for U.S. small businesses. For example, the regulatory burden facing entrepreneurs has increased in each of the last four years; funding for key SBA programs has been cut or eliminated; contracting opportunities for small businesses have not kept pace with the unprecedented growth of the federal marketplace; and fees for the SBA's flagship loan program have doubled. These setbacks are particularly disheartening considering that bipartisan solutions, that bridge both party and ideological lines, have been proposed for many of these issues.

Small business owners were optimistic that the $108^{th}$ Congress would provide unprecedented opportunities to address their needs. The President announced a highly touted Small Business Agenda, the Republican Congressional Leadership promised action and controlled the House and Senate, and bipartisan solutions were on the table. Unfortunately, the end result was one of the most disappointing small business records of any Congress.

The Bush Administration and Republican Congressional Leaders refused to negotiate key small business legislative packages, abandoned issues they championed at the beginning of the Congress as top priorities for entrepreneurial growth, and repeatedly discarded small business proposals in favor of measures that address the needs of large corporations.

The failure to address the needs of small businesses comes at a time when the economy continues to struggle; and our nation faces the largest federal budget deficit in America's history, a ballooning trade deficit, and massive job losses. Small businesses are central to improving the American economy. During the 1989-1993 recession, small firms created approximately 3.8 million jobs, outpacing large firms by nearly 500,000 jobs -- and they continue to add up to 80 percent of the net new jobs each year.

Small businesses, through their innovation and ability to adjust to a changing market, have a long record of effectively responding during difficult economic times. However, despite this resilience, they are unlikely to withstand another Congress that ignores their concerns in favor of their large competitors, or an Administration that not only fails to deliver on its promises, but actually makes it harder for small companies to succeed. If significant action is not undertaken during the next Congress, the single most important factor in economic recovery – small businesses – will be unable to provide the sustained economic growth and job creation this nation desperately needs.