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D.C. Circuit Court Upholds RFA, Orders FCC to Consider Impact on Small Business

On March 11, 2005, the U.S. Court of Appeals for the D.C. Circuit issued a ruling that strengthened the Regulatory Flexibility Act (RFA) and provided needed relief to small businesses. In *U.S. Telecom Assoc. and CenturyTel, Inc. v. FCC*, the court found that the RFA applies to a rule issued by the Federal Communications Commission (FCC) concerning wireless number portability, requiring the transfer of a telephone number from one carrier to another at a customer's request. The court sent the rule back to the agency with instructions to conduct a regulatory flexibility analysis. The court's decision

delayed enforcement of the FCC rule on small businesses until the agency finishes the regulatory flexibility analysis.

"This is a landmark decision for the RFA and a victory for small business. The court clearly ruled that federal agencies must follow the RFA, listen to the voice of small business, and consider alternatives that lessen the impact on small business before issuing a final rule," Chief Counsel for Advocacy Thomas M. Sullivan said.

This case is significant for three reasons. First, it reaffirms the

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Chief Counsel Thomas M. Sullivan presented representatives of four outstanding state programs with Best Practices awards at Advocacy's March conference. From left: Cindy Douglas, Michigan Economic Development Corporation; Pam Christenson, Wisconsin Department of Commerce; Martha Connolly, Maryland Industrial Partnerships; and Norris Krueger, Idaho TechConnect. See story, page 6.

Regulatory News

SBA and Advocacy Urge Congress to Modify Procurement Provision

Chief Counsel for Advocacy Sullivan joined SBA Administrator Hector Barreto and SBA Deputy Administrator Melanie Sabelhaus in asking Congress not to require small businesses to match the health care benefits offered by the federal government in order to be able to compete for certain Department of Defense contracts.

Their letter, sent March 15, 2005, to Chairman Jerry Lewis of the House Committee on Appropriations, deals with the undue effects on small businesses of Section 8014 of the FY 2005 Defense Appropriations Act. The provision bars the Defense Department from outsourcing work to the private sector under OMB Circular A-76 if the contractor's lower cost is achieved by (1) failure to provide employer-sponsored health insurance or (2) because the contractor contributes a smaller amount toward employee health benefits than the Defense Department pays for its civilian employees' health coverage.

While the intent of the provision is to encourage federal defense contractors to provide health care coverage for their employees, "the practical effect," the letter states, "is to bar small businesses from competing for these DOD contracts. This is a significant consequence, given that a substantial portion of the awards made by DOD would otherwise go to small and disadvantaged enterprises."

The terminology of the provision also penalizes employers for trying to lower their health care costs. According to the Council for Affordable Health Insurance, "this language discourages employers from providing their employees with health coverage that is more cost-effective than federal coverage... Additionally, it discourages competition in the health marketplace."

The letter can be viewed on Advocacy's website at www.sba.gov/advo/laws/comments/lewis05_0316.pdf.

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SBE Council Co-Hosts Event Featuring Advocacy Tax Research

Advocacy released its new tax report, *Taxes and Entrepreneurial Activity*, on March 2 at the National Press Club in an event co-hosted by the Small Business and Entrepreneurship Council. Raymond J. Keating, the SBE Council's chief economist, observed that the report's findings correspond to past trends in the economy when income tax rates have been reduced. "Over the past 85 years," Keating stated, "the U.S. has experienced four periods of substantive reductions in income tax rates—in the 1920s, 1960s, 1980s and now since 2003—and each time, the U.S. economy has experienced robust economic growth. The same goes for the five significant cuts in the capital gains tax implemented over this same period."

SBE Council President Karen Kerrigan added: "This report makes an important contribution to the current debate regarding the impact of tax policy. That's critical for efforts to make the 2001 and 2003 tax cuts permanent, as well as reforming the tax code."

Message from the Chief Counsel

Three Components of Tax Reform Needed—Lower Rates, Simplified Compliance, and Predictability

by Thomas M. Sullivan, Chief Counsel for Advocacy

Taxes are an important issue for every one of America's 23.7 million small businesses. In 2004 the National Federation of Independent Business (NFIB) ranked federal taxation of business income as one of the main issues for small businesses.

The vast majority of small business owners pay taxes as individuals: whatever earnings the firm makes are taxed as though it were the income of the individual proprietor. Thus, personal income taxes play a big role in the key business decisions entrepreneurs make—whether or not to start a business at all; when and how to expand; when to close up shop. Each decision is influenced, at least in part, by how much the small business owner can expect to pay in taxes.

The Office of Advocacy continues to produce research that demonstrates the impact of income taxes on small business owners. The most recent addition to Advocacy's research library is a study entitled *Taxes and Entrepreneurial Activity: An Empirical Investigation Using Longitudinal Tax Return Data* by Donald Bruce and Tami Gurley of the University of Tennessee. The purpose of the study was to discover how entrepreneurs—those who come up with the new ideas and take risks to open small businesses—react to income tax rates.

The results of the Bruce-Gurley study show, not surprisingly, that increasing marginal tax rates on business income reduces the chances that entrepreneurs will open new firms while it increases the likelihood that they will exit the market. A more subtle result of the study reveals that decreasing marginal tax rates across the board would

The study reveals that decreasing marginal tax rates across the board would increase the average small business lifespan.

actually spur entrepreneurship by increasing the rate of new firm formation and slowing the rate of firm closure; it would also increase the average small business lifespan. The bottom line: when marginal tax rates are lower, more budding entrepreneurs are able to start businesses and keep them running.

Recently, Professor Bruce presented his tax research to the President's Advisory Panel on Federal Tax Reform in Tampa, Florida. He highlighted his findings that tax rates have a strong impact not only on existing businesses but on future start-ups. This is a crucial consideration in the debate over tax reform plans. However, it is not the only important question. While small businesses care deeply about their total tax bill, the costs of actually complying with the tax code are an important and growing burden on small businesses.

The complexity of the tax code adds an additional burden to small firms that is not reflected in their tax bill the way that marginal rates are: that is, the cost spent complying with the law. A 2001 study published by the Office of Advocacy shows that tax-related paperwork costs are twice as high for a small business compared with a large one. Complicated depreciation tables, for example, exacerbate the severity of the compliance burden on small businesses.

A related component of tax complexity is tax permanence, the stability of the tax code from year to year. Small businesses are always better off when they can plan for the future with more certainty, and having a stable and predictable tax bill is a big part of certainty. A working paper by Office of Advocacy Economist Radwan Saade shows the benefits of predictability in the tax structure on the economy.

Small businesses are the core of the U.S. economy, generating two-thirds of the net new jobs and injecting the economy with innovation, flexibility, and dynamism. Advocacy will continue its research to help demonstrate the negative effects of the current tax regime on small businesses' critical economic contribution.

For More Information

The complete text of the new study published by the Office of Advocacy, *Taxes and Entrepreneurial Activity: An Empirical Investigation Using Longitudinal Tax Return Data*, is located at www.sba.gov/advo/research/rs252tot.pdf. The working paper by Radwan Saade, *Rules Versus Discretion in Tax Policy*, is located at www.sba.gov/advo/stats/wkp02rs.pdf. The 2001 study on compliance costs, *The Impact of Regulatory Costs on Small Firms*, by W. Mark Crain and Thomas D. Hopkins, is located at www.sba.gov/advo/research/rs207tot.pdf.

Highlights of Advocacy's Conference, "Putting It Together:



The day begins as speakers and panelists arrive early to prepare their presentations.



Advocacy Economist Ying Lowrey enjoys a moment before the conference with Henry Turner and Hope Lawrey of Howard University's School of Business.



Chief Counsel for Advocacy Thomas M. Sullivan launches the proceedings in the Atrium Ballroom of the Ronald Reagan International Trade Center.



The conference was attended by more than 200 representatives of the professional, government, and academic world devoted to entrepreneurship.



Chief Economist Chad Moutray listens as Zoltan Acs of the University of Baltimore considers a question. Seated next to him is Thomas Lyons of the University of Louisville.



Shanaveon Pious, chairman of Entrepreneurs University in Chicago, Illinois, poses a question to a panelist.

The Role of Entrepreneurship in Economic Development"



Deputy Chief Counsel Shawne McGibbon introduces Steven VanAusdle before his presentation, "Enhancing Rural Prosperity through Wine, Food, and Art."



Oklahoma Lieutenant Governor Mary Fallin speaks on regulatory relief, as Regional Affairs Director Viktoria Ziebarth looks on.



Assistant Secretary of Commerce for Economic Development David A. Sampson delivers the luncheon address.



Robert Litan, vice president for research and policy at the Ewing Marion Kauffman Foundation, raises a question after the luncheon address.



Kansas Lieutenant Governor John Moore takes notes next to Donald Bruce of the University of Tennessee, as Cali Beals presents Iowa's economic development programs.



Chief Counsel Sullivan and Daniel M. Sprague, executive director of the Council of State Governments, applaud the efforts of the conference participants.

Conference Report

Putting It Together: The Role of Entrepreneurship in Economic Development

by *Connie Marshall, Region X Advocate*

On March 7, 2005, the Office of Advocacy co-sponsored “Putting It Together: The Role of Entrepreneurship in Economic Development,” a daylong conference to explore the best practices of state leaders in formulating initiatives that spur entrepreneurship and economic growth. Selected leaders from across the country whose practices demonstrated market-based results came to Washington, D.C., to present their successes to their peers on a national stage. The panel discussions highlighted initiatives that have stimulated small business growth, created new jobs, and improved local economies.

A call for submissions was issued and regional advocates located across the country helped to identify the best examples of entrepreneurship. Region X (Alaska, Idaho, Oregon, and Washington) was well represented. Eight leaders were asked to create a submission.

Norris Krueger, a best practices award winner, was identified at Boise State University. Krueger is a program manager of the TEAMS initiative’s TechConnect program. Supported by the Kauffman Foundation, the TEAMS initiative seeks to expand student and faculty involvement in economic development and technology commercialization. TEAMS supports the state-wide efforts of TechConnect, which advances Idaho’s ambitious science and technology strategy.

In addition, Eric Blackledge, president of Blackledge Furniture in Corvallis, Oregon, and past chairman of the Governor’s Small Business Council gave a presentation on Oregon’s Innovative Economy Development Initiative. Oregon has made regulatory stream-

lining a priority; each Oregon state agency must now review its business regulations with a goal of reducing burdens while also not compromising standards and protections.

Daniel Mead Smith, president of the Washington Policy Center, a nonpartisan public policy think tank, presented the Small Business Project for Washington State. The Washington Policy Center serves as an advocate for small businesses and, using research as a tool, works with small businesses to provide a voice to legislators in pursuing policies favorable to the small business owner.

Steven Van Ausdle, president of Walla Walla Community College and the founder of the Center for Enology and Viticulture, presented a unique plan, Enhancing Rural Prosperity via Wine, Food, and Art. The strategy employed partnerships with the Walla Walla Wine Alliance, Washington State

Wine Commission, Washington State University, Yakima Valley Community College, Blue Mountain Arts Alliance, and the Walla Walla Valley Restaurants. His presentation turned out to be one of the conference favorites.

Was the conference a success? Absolutely! The Ronald Reagan Building and International Trade Center was buzzing with entrepreneurial ideas to the very end of the conference when Chief Counsel for Advocacy Tom Sullivan presented the Best Practices Awards.

The Office of Advocacy would like to thank our co-sponsors for this event. They include the Ewing Marion Kauffman Foundation, the Council of State Governments, and the National Lieutenant Governors Association. In addition, we would like to extend our appreciation to all of the panelists and state leaders who created submissions, particularly those from Region X.

Four Initiatives Cited As National Models

Four state initiatives were recognized for spurring entrepreneurship and economic growth and demonstrating market-based results at the March 7 conference. “Encouraging entrepreneurship is a key component of local, regional, and state economic development,” said Chief Counsel for Advocacy Thomas M. Sullivan. “The Best Practice winners show a clear dedication to innovations in public policy that encourage entrepreneurs and provide an environment where they can flourish. These programs demonstrate market-based results and ought to be replicated across the country.” The four winning initiatives are:

- Idaho’s “TechConnect” program, for Best Practice in educational efforts to promote entrepreneurship;
- The Maryland Technology Enterprise Institute at the University of Maryland’s “Maryland Industrial Partnership Program,” for Best Practice in technology transfer programs;
- The Michigan Economic Development Corporation’s “SmartZone” initiative, for Best Practice in regional economic incentives; and
- The Wisconsin Department of Commerce’s efforts to reduce state small business regulatory burden, for Best Practice in regulatory flexibility.

Research Notes

Small Business Lending on the Rise, Study Shows

Lending by commercial banks increased in the 2002-2003 period, according to a new report from the Office of Advocacy.

The report, *Small Business and Micro Business Lending in the United States, for Data Years 2002-2003*, includes lists of the top state lenders of loans under \$1 million and \$100,000, based on the Reports of Condition and Income (call reports) and Community Reinvestment Act (CRA) data. Four sets of tables rank large bank holding companies (BHCs) and

commercial banks nationally and by state. The report's findings also include the following:

- Small business loans outstanding (loans under \$1 million) totaled \$495 billion as of June 2003, an increase of \$11.1 billion or 2.3 percent between June 2002 and June 2003, compared with an overall increase of 5.1 percent over the previous period, according to the call report data.
- In 2002, a total of \$227.5 billion in small business loans under \$1 million were extended by 905

CRA-reporting banks/BHCs, compared with \$203 billion in 2001. Large multi-billion-dollar banks and BHCs made 5.3 million micro-business loans valued at \$73 billion in 2002, compared with 4.9 million loans valued at \$62 billion in 2001.

- The CRA data confirm the findings in the call report data of the importance of multi-billion-dollar banks and BHCs in the market for the smallest loans.

The complete report and bank ranking tables are available at www.sba.gov/advo/research/lending.html.

High School Education Rates Influence Economic Growth

Regional high school graduation rates have a tremendous impact on economic growth, according to a study released in March by the Office of Advocacy. The study, *Using Census BITS To Explore Entrepreneurship, Geography, and Economic Growth*, used the robust Business Information Tracking Series (BITS) dataset to test economic models, including reasons for economic growth.

"These findings show the importance of testing economic models with real world datasets," said Chad Moutray, chief economist for the Office of Advocacy. "Among other things, by using BITS we now know the significance of raising high school graduation rates to economic growth and entrepreneurship."

The report's authors, Zoltan Acs and Catherine Armington, relied on the BITS dataset for their findings. BITS was developed by the U.S. Census Bureau with support from the Office of Advocacy, and it tracks the employment and firm ownership of almost all private sector businesses from 1988 through 2001. BITS represents all industries; identifies start-ups of

both new firms and new locations of existing firms; and specifies the location, industry, and employment

of each establishment over time. The report is available at www.sba.gov/advo/research/rs248tot.pdf.



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Court Stands By RFA,

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importance of the RFA in agency rulemaking. Second, this decision was made by the D.C. Circuit, which is the appellate court most likely to hear appeals from federal agency rulemakings. Third, the FCC embraced the ruling as an opportunity to accommodate small business concerns.

The FCC had adopted the rule in response to a petition by the Cellular Telecommunications and Internet Association (CTIA). CTIA asked the FCC to require wireline carriers to transfer telephone numbers to wireless carriers whose service area overlapped a wireline carrier's rate center, even when no point of interconnection between the two networks existed. On November 10, 2003, the FCC granted CTIA's petition, stating that the order "clarified" an earlier final rule, hence it was not a legislative rulemaking requiring notice and comment under the Administrative

Procedure Act. The FCC did not conduct an RFA analysis of either CTIA's petition or of the resulting final rule.

Two small business organizations that represent small and rural wireline carriers—the National Telephone Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO)—challenged the order on December 15, 2003, on the grounds that it violated the RFA. The two groups charged that the rule would cost their small business members an estimated \$76,000 per telecom carrier in initial costs and \$46,000 in annual recurring costs.

On February 13, 2004, the Office of Advocacy filed a Notice of Intent with the U.S. Court of Appeals for the D.C. Circuit that it was preparing to file an *amicus curiae* (friend of the court) brief in support of the challenge by OPASTCO and NTCA. On June

10, 2004, Advocacy and the FCC reached a settlement. Advocacy withdrew its intent to file, and FCC Chairman Michael Powell issued a letter to state regulators, urging them to consider the burdens of the local number portability requirement on small rural carriers if they petitioned for relief.

The settlement between Advocacy and the FCC did not keep the case from going forward, and on March 11, 2005, the U.S. Court of Appeals for the D.C. Circuit issued a decision that concluded that the FCC failed to comply with the RFA's requirement to prepare a final regulatory flexibility analysis regarding the order's impact on small entities. The court remanded the order to the FCC to prepare the analysis. In addition, it stayed the effect of the order as it applies to those carriers that qualify as small entities under the RFA. The court's ruling is online at www.cadc.uscourts.gov/internet/internet.nsf.

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