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The Small Business Advocate

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Study Examines Silicon Valley's "It" Factor

The Silicon Valley phenomenon of innovative, high tech entrepreneurship fascinates small business researchers. But is Silicon Valley really more entrepreneurial than other areas? And if so, why? A new report published by the Office of Advocacy takes a close-up look at this gem of American high tech entrepreneurship and compares it with other geographic areas known for their entrepreneurial edge.

Entrepreneurship in Silicon Valley during the Boom and Bust, written by Robert Fairlie of the University of California at Santa Cruz with Advocacy funding, examines the reasons for the rates of entrepreneurship in the dot-com boom and post-boom periods. The report shows that while high, Silicon Valley's entrepreneurship rates are not unique. However, the factors that drive them may be.

"There appears to be something special about Silicon Valley," said Chad Moutray, chief economist for the Office of Advocacy. "Controlling for the factors we know contribute to high rates of entrepreneurship still doesn't explain what has happened in the Valley. While not the highest in the country, Silicon Valley's consistently high rates of entrepreneurship appear to be driven by factors that have yet to be measured."

The study finds that Silicon Valley's entrepreneurship rate, as measured by the Kauffman Index of Entrepreneurial Activity, was consistently higher than the national rate during the dot-com boom of the late 1990s. However, several other metropolitan areas had higher rates of entrepreneurship during the same period. In the post-boom period, Silicon Valley's entrepreneurship rate rose higher. This suggests that the tight labor market, high wages, and generous stock options of the boom period may have suppressed entrepreneurship.

The study examines factors known to contribute to entrepreneurship. Silicon Valley is a particularly rich entrepreneurial environment because of its large concentration of immigrants and highly educated workers. Both of these factors are associated with high levels of entrepreneurship. Even after controlling for these factors, the Silicon Valley rate remained

Continued on page 3

Region X Advocate Connie Marshall was featured on Bizline radio in March. Now in its third season, Bizline provides an array of business insight through interviews with business owners and experts. Current and past shows are archived at **www.bizlineradio.com.**

In This Issue

Advocacy Publishes New Guide to State Regulatory Flexibility

On March 28, the Office of Advocacy released a new guide for state policymakers and small business people interested in making state regulations less costly and burdensome for small firms. The new guide was released at the state small business regulatory "best practices" conference in Kansas City, Missouri.

The *State Guide to Regulatory Flexibility for Small Businesses* is full of tools and links to make life easier for state regulatory reformers. The guide notes that agency education, small business activism, and executive leadership are key to implementation. It cites many examples:

• Governors in Arkansas and Massachusetts have actively supported their state's regulatory flexibility initiatives.

• Colorado has reached out to engage small businesses in the process of developing better regulations.

• Several states are developing regulatory flexibility training modules and curricula; among them are Alaska, Wisconsin, and South Carolina.

Do you need to know how to use state data to analyze regulations and craft better alternatives? The guide addresses this topic, and it lists websites of the state agencies that offer labor market information. In addition, it provides information on Internet tools that are being used to create transparency in the rulemaking process.

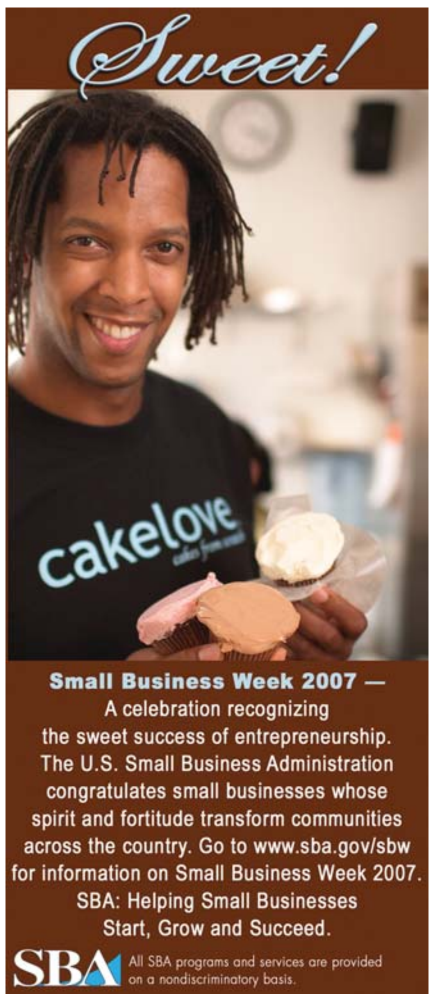
To learn more, check out the guide at **www.sba.gov/advo/laws/rfa_stateguide07.pdf**.

Structural Factors Affecting Health Care Coverage of Small Firm Workers

A new report by the Office of Advocacy examines structural factors affecting health care coverage of small firm workers. Unlike most previous efforts of analysis, the study focuses on state and metropolitan statistical area (MSA) factors that influence employer-sponsored insurance coverage rates and per capita health care expenditures.

The report finds that the two most important factors associated with low employer-sponsored insurance rates are employee wages and firm size. It also examines MSA and state structural factors such as the concentration of Medicaid recipients, the concentration of manufacturing employees, the supply of hospital beds, and the amount of specialty health care services.

Econometrica, Inc. wrote the study, *Structural Factors Affecting the Health Insurance Coverage of Workers at Small Firms.* The complete report is online at **www.sba.gov/advo/research/rs295tot.pdf**.



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Tax Day Message

Tax Simplification—A Long Overdue Remedy for the Small Business Tax Burden

by Candace Ewell, Assistant Chief Counsel, and Radwan Saade, Regulatory Economist

Tax policy is an area of perennial concern to small businesses, most of all because small businesses are hit so hard by the prevailing tax code. Research published by the Office of Advocacy has cast a bright light on the uneven burden that falls on small businesses in complying with the federal income tax structure. Small businesses with fewer than 20 employees spent $1,304 per employee to comply with federal income taxes in 2004. This amount is almost two times as much (per employee) as businesses with more than 500 employees spent.

One reason for the high per-employee cost to small businesses is the level of complexity in the tax code. Compliance with the tax code places a substantial burden in paperwork and recordkeeping on any firm with a payroll, even before the first paycheck is cut. These costs are largely fixed. Bigger firms are able to spread the costs over a greater number of employees than smaller firms, reducing the average cost per employee. But for small firms these costs can be significant.

Concerns about the complexity of the tax code are not new in American public policy debates. Discussions about complexity began when the income tax was reinstated in 1913. To take advantage of most tax expenditure programs, the taxpayer must do a certain amount of recordkeeping and fill out appropriate paperwork to attach to the tax return. Both the number of restrictions on the various tax expenditure programs as well as the burdens incurred to avail oneself of them contribute to the tax code's complexity.

A second aspect of the prevailing tax code exacerbates issues of complexity, namely uncertainty over future tax obligations. Entrepreneurs have increased difficulty with both setting and executing business plans in our current tax environment. Uncertainty affects taxpayers' planning horizons, and reduces both their expected benefits and feasibility. Consequently small business taxpayers face uncertainty from two directions: tax complexity and tax rates. As complexity increases, compliance costs rise; as a result, taxpayers become uncertain as to their total future tax burden. Complexity adds to the hurdles that small businesses must overcome. Changes in the code from year to year add to the uncertainty in the tax code, creating a deterrent effect on small firm hiring and investment. Clearly, complexity and uncertainty in the tax code are important issues for small businesses in particular.

"One reason for the high per-employee cost to small businesses is the level of complexity in the tax code."

Economists have traditionally concentrated on the tradeoff between efficiency and equity in crafting tax policy. The efficiency of a particular tax policy proposal is judged by whether it lets resources be put to their best possible use. Equity considerations strive to spread the tax burden as evenly as possible over the intended population. Complexity (or its opposite, simplicity) is the third leg of the tax policy framework, and it is often overlooked. An ideal tax system would balance the efficiency and equity of taxes and be as simple as possible. Since simplification of the tax code often involves sacrificing equity, or at least perceived equity, resistance to simplifying proposals is high.

The cost of compliance—the number of hours spent on recordkeeping and form-filling—is a measure of complexity. The lack of emphasis on simplicity in recent times has led to a bloated tax code where compliance costs have become a significant portion of many taxpayers' overall tax burden.

It has long been suggested and agreed that the health of the small business sector and the economy at large can be improved by well-understood policies that promote simplicity. The Office of Advocacy is committed to tearing down hurdles that inhibit small business growth and entrepreneurship. Our office strives to make sure that America's entrepreneurs can operate and prosper in an environment in which they fully understand their tax obligations and willingly comply. Such understanding, however, will not occur until tax simplification becomes a priority.

Silicon Valley, *from page 1*

high—evidence that there is a further, yet-to-be-measured factor that drives entrepreneurship.

This new report brings us one step closer to understanding this phenomenon. The report and research summary are posted on Advocacy's website at **www.sba.gov/advo/research/rs296tot.pdf.**

Arkansas Governor Signs State Regulatory Flexibility Bill Into Law

The regulatory environment for Arkansas' 238,000 small businesses just got a little friendlier, thanks to a new law signed into law by Governor Mike Beebe. The new law, Senate Bill 55, requires state agencies to analyze the economic impact of a proposed rule on small businesses and to consider less burdensome alternatives that will accomplish the regulatory goal. The law directs agencies to consider the unique needs of small business to help them to survive in a competitive marketplace.

Many of the bill's sponsors were on hand for the signing on March 2. From left are National Federation of Independent Business State Director Bill Phillips; State Senator Denny Altes (Senate sponsor); SBA District Director Linda Nelson; State Representative James Norton (House sponsor); Arkansas Small Business Development Center Executive Director Janet Roderick; NFIB State Leadership Council Chairman Jim Davis; Arkansas Governor Mike Beebe (seated); Gary Ferrell, of Staley Electric Company and Associated Builders and Contractors of Arkansas; Charles Mazander of Mazander Engineering and the Arkansas State Chamber Small Business Council; Region VI Advocate Eric Munson; State Representative Sid Rosenbaum (House sponsor); National Organization of Women Business Owners Director Laura Fine; University of Arkansas at Little Rock SBDC Training Coordinator Jennifer Bonds; and SBA Arkansas District Chief Counsel Lynley Arnett.

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