

# U.S. INNOVATION & GROWTH: SMALL & MID-SIZED BUSINESS

## **The Strengthening America's Future Initiative Issue Paper**

A Project of the  
Center for the Study of the Presidency and Congress

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*The views expressed in this report do not necessarily reflect the views of the individual members of this issue team or their institutions. In some cases issue team members have offered dissents to specific sections of the issue paper.*

### **Principal Project Supporter**





# **Strengthening America's Future Initiative (SAFI)**

## *U.S. Innovation & Growth: Small & Mid-sized Business*

### **Summary**

Between 2001 and 2007, small and medium-sized businesses created 72 percent of all new jobs in the United States. Since the country entered a recession in the fall of 2007, 79 percent of all the jobs lost have come from small and medium sized firms as well. Small businesses make the U.S. economy flexible and robust in the face of technological change and global competition, but they are also vulnerable. Ensuring the future vitality of the small business sector requires a comprehensive policy approach that cogently links across a series of front burner issues facing the country. This report outlines policy recommendations in four key areas that affect the competitiveness of small and medium-sized businesses: health care reform, immigration reform, access to capital, and regulatory reform.

### **I. Healthcare Reform**

- Key Issues: Small businesses' competitiveness in global markets and relative to larger competitors is weaker because health insurance costs them more. Lack of competition and lack of ways to pool risk are the roadblocks to achieving parity.
- Recommendations: (1) Create purchasing cooperatives, which help smaller companies pool risk and resources on par with large employers; (2) Institute insurance exchanges, which will create competition for small companies' business; and, (3) Reform the tax laws which currently penalize owners of very small businesses and sole proprietors.

### **II. Immigration Reform**

- Key Issues: America has long attracted some of the most talented people in the world to build companies in this country. Talented foreign workers contribute greatly to the ability of smaller companies to thrive. Yet, the current system lacks clarity. That lack of clarity leads some workers to be exploited in some cases and to situations where the presence of foreign workers circumvents the intended goals of our immigration policies.
- Recommendations: While calling for fundamental reforms to ensure that foreign and domestic employers do not misuse the program, we call for a significant expansion in the number of H1-B visas and green cards available to workers in small businesses. Reforms must create protection against outsourcing while at the same time address the broader set of issues facing the larger group of undocumented workers on which many small employers depend.

### **III. Access to Capital and Tax Policy**

- Key Issues: As we have all learned in the last year, access to capital and credit is the lifeblood of a healthy economy. The financial crisis has made it more difficult to obtain credit, which has affected all small businesses, and it has led to a marked decline in venture capital investment, affecting the ability of high tech businesses to gain access to the kinds of patient investors that are needed to innovate effectively. At the same time, current tax policies can be counterproductive in that they discourage reinvesting profits back into growing companies under certain ownership structures.

- Recommendations: The Administration should continue efforts to maintain maximum sustainable liquidity in credit markets. It should examine current efforts to close investment gaps by using a data driven approach to supporting small businesses through tax credits. And it should examine changing the tax code to provide incentives for the owners of small companies to reinvest profits.

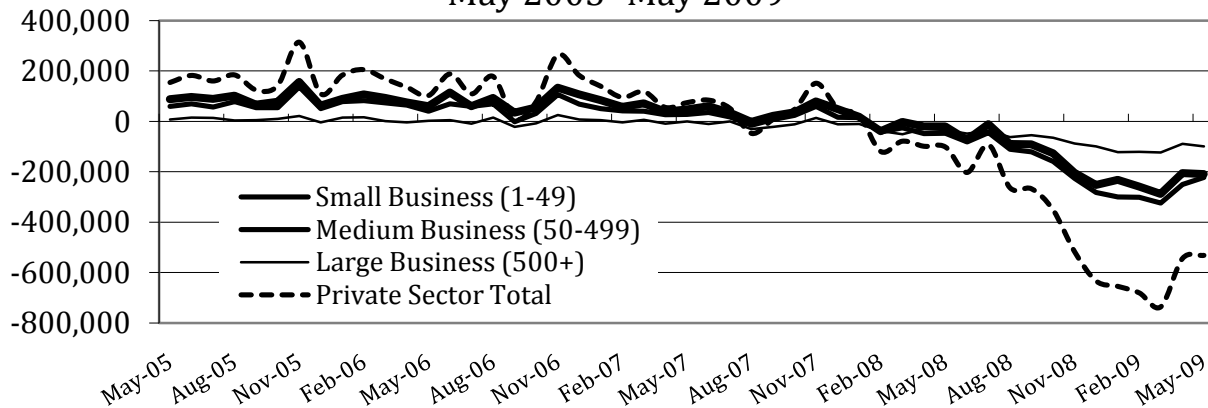
#### **IV. Regulatory and Interagency Organizational Reform**

- Key Issues: Regulating companies – of all sizes – is necessary to ensure a level playing field and to protect the interests of consumers, workers and communities. However, regulations are often a blunt instrument which can stand in the way of competitiveness. At the same time, the federal government can play a constructive role by facilitating relationships and enhancing trade opportunities. However, this constructive role requires a coherent and comprehensive approach across departments, branches and levels of government. Currently, the concerns of small businesses are spread throughout a series of agencies and the small business community lacks a focal voice with the ear of key decision-makers.
- Recommendations: Efforts already underway to review regulations affecting small companies should be continued. As, if not more importantly, small business needs a clear voice in the deliberations of key boards affecting national policy. This should include a permanent representative for small and medium sized businesses on President’s Council of Economic Advisors.

# Introduction

Small and mid-sized businesses are vital to the economic health of the United States. According to the Bureau of Labor Statistics, companies with 500 employees or fewer account for over 50 percent of the non-farm work force including 80 percent of employment in construction, and well more than 50 percent in real estate, arts and entertainment, professional services and the restaurant industry. Most importantly, small and mid-sized businesses were credited with creating 72 percent of new jobs between 2001 and 2007. Of course, what goes up comes down and as the chart below shows, since the recession began in the fall of 2007, businesses with fewer than 500 workers have shed fully 79 percent of the nearly 5,900,000 jobs that have been lost.<sup>1</sup>

Month-on-Month Change in Employment by Company Size:  
May 2005- May 2009



This document outlines and prioritizes initiatives in four key areas affecting the competitiveness of small and mid-sized businesses in the United States: health care, immigration, access to capital, and regulatory and organizational issues related to the small and medium sized business community. In assessing policies affecting small and mid-sized companies, two competing goals are apparent: (1) the need to establish ground rules for businesses which ensure the sustainability of communities, families and the economy; and (2) the need to enhance and protect the potential of small businesses to create value and grow wealth. Balancing these two goals requires paying close attention to the precarious position in which many small firms find themselves. While large companies typically have the infrastructure and the assets to handle regulatory requirements with relative efficiency, small and mid-sized companies are more vulnerable.

The sections that follow give an overview of the important dimensions of the issues as they impact small and mid-sized businesses, outline major policy options as well as the important voices associated with those options, and provide a set of recommendations for the issue group to consider as next steps.

## I. Health Care

The most pressing issue facing small and medium sized businesses is the struggle to provide health insurance to employees. A Kaiser Family Foundation report<sup>2</sup> shows that 20 million of the 45.7 million U.S. residents without health insurance are either employees or family members of employees of businesses with 50 or fewer workers. And the problem is growing. A recent GAO report<sup>3</sup> showed that, while large employers offering health benefits have remained fairly constant at about 98 percent, coverage among employers with between 3 and 199 employees has dropped from 68 percent to 60 percent since 2001. Among smaller employers who continue to offer health insurance, many have either had to suppress wage increases in order to pay for premiums or have passed an ever greater percentage of the

costs on to their workers. As the country considers options for reforming health care, it needs to place a high priority on ensuring health coverage for employees of small and medium sized firms. In doing so, it should be guided by a policy that trims costs while expanding choices for high-quality health care.

## **Policy Options Under Consideration**

### *Purchasing Cooperatives*

Health care costs have risen at a relentless pace over the last 25 years, and the evidence is clear that those costs are borne disproportionately by small businesses. The Kaiser Family Foundation reports<sup>4</sup> that small and medium sized businesses' insurance premiums are 18 percent higher on average than those of larger companies. The difference is partly due to higher administrative costs (large companies benefit from economies of scale), but is also due to the fact that large employers have the capability and resources to self-insure, which allows them to circumvent coverage mandates. Smaller employers do not have the resources to avail themselves of this option.

Purchasing cooperatives would allow smaller companies to ally with each other in order to purchase insurance coverage. They would help to overcome these barriers while also allowing small employers to gain some of the advantages that larger employers enjoy with respect to both administrative costs and negotiating power. From the insurance perspective, associations are also a means of pooling risk. Any reform of the system should include encouraging the formation of these kinds of groups nationwide. Doing so will both help to increase choices available to small employers while at the same time improving the quality of competition in the marketplace which could help to contain costs over the long-term.

### *Insurance Exchanges*

One factor contributing to the problem is the lack of competition among insurers for small employers' business. Consolidation within the health insurance industry has worsened the problem, turning many markets into oligopolies. A GAO study<sup>5</sup> of competition among insurance providers for the small employer market in the 50 states finds that the median market share of the largest small group carrier increased from 33 percent in 2002 to 43 percent in 2005 and reached 47 percent in 2008. In 34 of 39 states, the five largest carriers combined accounted for three-quarters or more of the small employer market, up from 26 of 34 states in 2005 and 19 of 34 in 2002.

Currently, competition in the private health insurance markets focuses largely on obtaining the lowest-risk enrollees. Yet research shows<sup>6</sup> that the sickest 1 percent of the population accounts for nearly a quarter of all health care spending and the top 10 percent accounts for two-thirds of health care spending. The healthiest half of the population accounts for only 3 percent of spending. As a result, the financial gains to insurers able to enroll the best risks are tremendous. Insurance exchanges – including the one implemented in Massachusetts as part of its 2006 comprehensive health care reform law – are intended to shift competition toward a lower cost instead. Exchanges do this by providing incentives for increasing the number of available plans, establishing common rules regarding how insurance is priced, and providing information to help consumers better understand the available options.

### *“Pay or play”*

The American system of employer-based health care coverage grew out of war-time restrictions on wage and salary increases. With that option closed off, employers competed over workers by offering fringe benefits including health care. These benefits quickly became the norm and were institutionalized through law and regulation. However, existing regulations also allow employers to decide whether or not to provide insurance. As the cost of providing coverage has gone up much faster than the rate of inflation, the number of insured Americans has gone down. Just as competitive pressure in the 1940s and 50s impressed the need on companies to offer insurance, a similar dynamic is now occurring as more

companies cut their benefits, pushing many employers to abandon coverage or suffer a competitive disadvantage to their efficiency. If the country is to maintain the employer based system at all, it must decide whether to maintain the current voluntary approach or level the playing field by requiring employers either to offer insurance or contribute to a public fund that will help to subsidize individuals' ability to purchase coverage. This mandate is known as "pay-or-play."

Any policy that imposes an employer mandate must take into consideration the precarious situation of small companies. The full burden of paying for the expansion of health insurance reform should not rest on small and medium-sized companies struggling for their own survival. Credits and tax exemptions provide some relief, but any policy which is eventually enacted must be careful not to lead to unforeseen or hidden administrative and financial burdens that might counteract the ultimate goal of ensuring greater choice and market-based cost controls. Other options – including re-examining the blanket tax-exemption associated with medical insurance – should be considered as alternatives.

### *Personal Health Savings Accounts*

Employer-based health care coverage is likely to remain the foundation on which working families in the United States receive medical coverage. However, many see this system as a recipe for continued disaster: individuals who are not personally responsible for the costs associated with their own health care demand care at higher cost and with uncertain effectiveness because they do not bear the downside risks associated with these choices. Tax-sheltered personal health savings accounts are one approach to addressing this problem. In addition to potentially correcting the moral hazard problem, personal health savings accounts also effectively eliminate overhead costs for employers.

There are several problems with a system based entirely on individual coverage. First, employer-based and public insurance allows risk to be spread across a population. This is not as possible under an individual-based insurance scheme and as a result, the poor, disadvantaged minorities, and others with existing conditions could be put at a significant disadvantage. Moreover, the administrative costs of such plans – while more efficient for employers – are far less efficient for the system overall, which could potentially lead to increasing the cost of health care.

For these reasons, expanding personal health accounts to become the primary vehicle for delivering health insurance is unlikely, both from a political and a policy perspective. However, as increasing wealth and prosperity leads many Americans to want to spend more on purchasing high quality health care, it does make sense to examine ways of intermingling personal and employer-provided insurance. The most compelling approach would see voluntary or elective procedures migrate to personal insurance coverage while leaving non-elective and catastrophic care to a combination of employment-based and public insurance.

### *The "Public Option"*

Among the elements of health reform being discussed in Washington D.C., perhaps none has been the subject of as much debate as the prospect of a public option. Its proponents suggest that the only way to make health care more affordable is to provide a lower cost, high quality public sector offering available through the National Health Insurance Exchange or perhaps through the states to compete with private insurers. The plan would be available through the exchange where employer and individuals who do not have insurance through an employer or other public program like

Medicaid, can compare and buy policies. Public option supporters believe that competition would help drive down health insurance costs across the board, reducing costs to the American people and the federal government. It would also allow employees to maintain insurance between jobs, as their insurance would not be tied to a specific employer. Finally, it would benefit the self-employed, who often get poor insurance rates because they are essentially a risk pool of one.

Opponents of the public option maintain that it will drive private insurers out of the market because they will not be able to compete. Furthermore, opponents point out that Medicare (health care for the elderly) and Medicaid (health care for low-income Americans and the disabled) are both projected to be trillions of dollars over budget within decades, due to increasing healthcare costs and an aging population with longer life expectancy. Why, they ask, should the government risk spending hundreds of billions of dollars on a program that will end up increasing the federal government's fiscal burden?

Under the right circumstances, a public option could help control costs both by addressing the lack of competition in the market and by creating a low-cost competitive benchmark. From the perspective of small and medium-sized business, the main criterion on which it needs to be judged is whether it will achieve the goal of bringing down costs so that companies can afford to offer insurance at all. And should it be enacted, care needs to be taken in the implementation to ensure that the goal of cost containment remains paramount. Careful consideration of the implications of the public option for small businesses, including ways to finance it, will be essential in crafting healthcare reform based on best practices that provides insurance for working people and their families, while containing costs, so that entrepreneurship can flourish in the United States.

### **Priorities: Health Care Insurance Reform**

- As the costs of providing health care push ever more small and medium-sized employers out of the market, the cost of caring for the uninsured gets passed on to those who remain insured. This is an unsustainable, vicious cycle and it is imperative that the Administration address the problems as soon as politically and technically feasible.
- Within the first year, the Administration should:
  - Provide small and medium sized companies with the ability to form cooperatives to purchase health coverage.
  - Pass legislation to create insurance exchanges that will increase the quality and scope of health insurance plan choices for smaller companies and to individuals.
  - Devise a workable formula for providing subsidies, credits and tax exemptions to struggling small businesses that will require assistance to provide coverage to employees.
- Within two years:
  - Restructure the way health benefits are taxed. Currently, health benefits of the smallest employers and sole proprietors are taxed, a situation which places them at a competitive disadvantage relative to larger employers. If benefits continue to be tax-deductible for other employers, these taxes should be eliminated for the smallest employers as well. However, in seeking ways to pay for the general expansion of care, the federal government should examine other ways of generating revenues through tax policy. Whatever the outcome, the policy should be consistent for employers of all sizes and structured in such a way as to encourage the ability of smaller companies to compete, grow and contribute to the economy.
- Within the first term:
  - The current employer-based approach to funding health care is a mixed bag. While major reform of this system may have to wait, the Administration should revisit this question once the current reform efforts take effect. Achieving a sensible balance between individual, employer and public insurance options is in the long-term interest of the nation.

## **II. Immigration**

American companies' competitiveness is predicated on open and free labor markets and ensuring employers' access to highly skilled workers. Immigration plays an important role in achieving these

goals. Moreover, evidence suggests that skilled immigrant workers are more likely than the general population to start companies and to engage in activities leading to innovation.<sup>7</sup> At the same time, America's prosperity attracts many less-skilled workers from around the world whose contribution to the economy is important.

High-skilled workers can enter the U.S. labor force by obtaining an employment-based green card, which allows an individual to stay in the United States as a permanent resident or an H-1B visa, which allows an individual to work here for three years, renewable to six years. Current law limits the annual number of H-1B visas to 65,000 with an additional exemption of up to 20,000 foreign nationals holding a master's or higher degree from a U.S. university. The annual cap on green cards for skilled workers is 40,000.

Demand, for both H-1B visas and green cards, far outstrips supply.

The result is that many high-skilled workers in scientific and technical fields who are currently working in the United States on temporary H-1B visas are forced to leave their jobs each year and return home.

Similarly, many foreign students completing scientific and technical training at U.S. colleges and universities who would otherwise remain to work and build companies in the United States returning to their home countries, taking their U.S. acquired human capital with them.

Critics of the current cap levels complain that the country is leaving billions of dollars on the table. The consequences are particularly acute for the prospects of America's high tech sector. A recent Kauffman Foundation report showed that immigrants were CEOs or lead technologists in one of every four tech and engineering companies started in the United States from 1995 to 2005 and in 52 percent of Silicon Valley startups. These immigrant-founded companies employed 450,000 workers and generated \$52 billion in revenue in 2006.<sup>8</sup>

The current system is also vulnerable both to fraud and to unintended consequences that counteract the benefits associated with immigration. Specifically, critics complain that the current system is open to abuse by companies seeking to establish relationships in the U.S. that can then facilitate off-shoring work. In addition to these concerns of fraud and abuse, it is estimated that approximately 8.3 million undocumented workers are currently living and working in the U.S. This represents roughly 5.4 percent of the US labor force generally and a much larger percentage in some industries in which smaller employers dominate such as construction (17 percent of total employment) and food service (12 percent of total employment).<sup>9</sup>

The role that immigrant workers play in society is politically contentious and the policies governing this aspect of the labor market are muddled at best. The current approaches have had the doubly problematic effect of diminishing our ability to attract the most highly sought-after workers while also maintaining policies that contribute to the exploitation and uncertainty of unskilled laborers. To address these problems, the country must reexamine its approach.

### **Priorities: Immigration**

- Within one year:
  - The Administration should propose expanding the number of green cards and H1-B visas available. To facilitate the goal of increasing access to skilled workers available to work in high growth, innovative companies, the lion's share of additional visas could be offered on condition that the worker is employed by a small or medium sized company (i.e., an employer with fewer than 500 workers or less than \$10 million in revenues).
- Within two years:
  - The Administration should propose changes to the H1-B visa program to guard against misuse of the program that might result in jobs unintentionally being

outsourced. Any review of the existing policy should examine whether a change in existing law would adequately address the concerns that Senators and others have expressed over the connection between guest workers and outsourcing.

- Within the first term:
  - The Administration must revisit the question of “low-skilled” and undocumented workers. Contrary to popular perception, a fair amount of consensus exists on this issue with most analysts agreeing that some kind of amnesty with a fair, but fairly permissive, route to citizenship is needed. To do otherwise would be both ethically and economically unfeasible and ill-advised. The problem is how to handle the politics with several major constituencies ideologically (and reflexively) opposed to granting undocumented immigrants legal status retroactively. As a result, these workers remain in limbo which – while not as ethically or economically dangerous as mass deportation – is nevertheless problematic. The Administration should build political consensus around a comprehensive reform effort.

### **III. Capital Access and Taxes**

The relative ease with which small American companies have gained access to credit and other methods of raising capital has given our nation a comparative advantage over other nations. The Federal Reserve’s last comprehensive survey<sup>10</sup> of small businesses’ access to capital (conducted in 2007) found that debt financing increased at a rate of 9 percent between 2002 and 2007 reaching a total of \$3.1 trillion. Venture capital investment grew over that same period from \$20 billion to \$28 billion. These increases were fueled by a combination of financial services deregulation, improvements in information technology, and innovations in finance, which all contributed to easing the process of securing credit.

Increasing sophistication among venture capitalists and angel investors as well as the emergence of trading platforms specializing in entrepreneurial companies led to general expansion in access to investment capital among small and mid-sized businesses after the post-9/11 downturn. However, these trends reversed with the onset of the financial crisis. Moreover, credit in various forms has become tougher to secure and more expensive as angel and other forms of VC investment have taken a significant hit. Policy proposals currently circulating focus largely on addressing the short-term concerns created by the financial crunch, but would still have longer term policy implications.

#### **Policy Options**

##### *SBA Loan Guarantees*

Historically, small businesses have posed higher variability risk for banks and other loan makers than larger businesses. Because of the size of the loans involved, small business loans are less financially lucrative and involve higher administration costs than the financing of larger ones. The federal government’s Small Business Administration loan guarantee program is intended to address these gaps by insuring loans made to qualifying small businesses by private banks.

However, a study released by the Urban Institute in early 2008 casts some doubt on the efficacy of the program.<sup>11</sup> Their research utilized rigorous econometric techniques to examine whether the SBA’s various loan guarantee programs result in improved sales or employment when compared with other factors such as geography, company characteristics, market conditions and the availability of other financing mechanisms.

As lending practices have tightened, lending from local outlets has become the primary alternative for small business financing. As of June 2009, the SBA has temporarily increased loan guarantees from 85 percent to 90 percent as well as altering the size standard, actions which they estimate will open 7(a)

eligibility to an additional 70,000 small businesses. The expansion of the SBA's flagship 7(a) loan program will continue through September of 2010. One remaining area of concern is the SBA's ability to process a higher volume of loans at their current staffing levels, an issue that has yet to be addressed. Even more recently, the Administration has taken action to utilize part of the TARP funds to loosen up lending to small and medium-sized businesses through the 7(a) program.

The SBA's loan program is popular. But it is also ripe for re-examination. Currently, little data is collected examining how funds are used and whether the program is reaching all kinds of small businesses effectively. As it stands, the program is largely oriented toward companies with significant capital equipment needs. One idea is to build on this as the program's base, but to look for opportunities to support companies seeking to upgrade capabilities. Firms, in which funds would go to activities such as building innovative capacities, establishing relationships with universities, or investing in information technologies that facilitate lean-manufacturing, could be eligible for more favorable loan terms than other companies. At the same time, more data should be collected on the use of funds made available through the program to facilitate making evidence-based decisions that would help channel funds toward the most productive uses.

#### *Taxes*

Tax breaks extended to smaller businesses are an important policy tool typically meant to provide incentives for particular kinds of spending. However, as the country looks toward making general changes in the tax code, we should consider implications for investment and access to capital in small and medium-sized companies. Specifically, many small and medium-sized businesses are limited in their ability to raise capital internally since profits are taxed as ordinary income to the individual owner or owners. This policy should be reexamined.

The problem mainly affects companies incorporated as "S-corps". In many small-to-medium sized businesses – particularly entrepreneurially-driven enterprises – ownership is concentrated in a few hands and they are therefore incorporated under chapter S of the U.S. Tax code. Larger companies are incorporated under Chapter C of the Code, in which the corporation's profits are directly taxed, as opposed to the profits of so-called S-Corps, which are taxed indirectly. Profits are distributed to owners and then taxed at the owners' individual tax rates. As it stands currently, the combined corporate and individual tax rates which apply to S and C corporations are comparable. However, increasing taxes on wealthy individuals could upset that balance. This could have a material impact that could diminish the amount of capital available to be invested in small and medium-sized companies by those companies' owners.

One approach would be to create parity between S and C corporations' taxes by increasing rates on larger C corporations. But that would only exacerbate the competitiveness challenges we face. An alternative, however, would be to distinguish between profits distributed to owners and profits that are reinvested in the business. These profits could be taxed at different rates in such a way as to encourage reinvestment. We recommend examining the second course in greater detail.

#### *Credit cards*

Revolving credit has become a major concern. The National Small Business Association polls members on credit card use.<sup>12</sup> In December 2008, they found that 49 percent of member businesses reported using credit cards in the past 12 months to finance their firms. By April of 2009, that number had jumped to 59 percent. As the credit crisis has unfolded, credit card issuers have tightened restrictions and taken unilateral actions intended to shore up their own financial standing. Unfortunately, doing so has imposed hardships on small business owners.

The President has already undertaken a series of initiatives to ensure continued access to revolving credit. The NSBA has offered a number of suggestions in light of the recent shifts they observe in the way credit card issuers are treating small businesses. Specifically:

- Prohibit universal default
- Prohibit double-cycle billing
- Prohibit retroactive interest rate hikes
- Limit the interest rate percentage increases that card issuers can impose on holders
- Require card issuers to apply a customer's payments to the card balance with the highest interest rate first
- Prohibit extra interest charges on card debt that the cardholder already paid in full
- Prohibit interest charges on transaction fees
- Prohibit late fees if an issuer's action caused a delay in crediting a payment, and
- Establish an industry-wide practice regarding the time on which a payment must be received or sent to be considered on time.

### *Venture Capital*

Venture capital investment is a vital component of the growth of small and mid-sized businesses. While bank loans and other forms of credit provide the lion's share of small and mid-sized firms' financing, venture capital – including investments from families, angel investors and private equity – continues to play an important role in financing high-growth-potential companies. A 2007 Federal Reserve Report<sup>13</sup> on sources of financing for small and mid-sized businesses, notes that venture capital investment experienced a significant bubble in the late 1990s which grew to over \$100 billion before crashing in 2001. As of the first quarter of 2009, private venture capital investments totaled approximately \$28 billion. Despite that precipitous drop in investment, the vitality of the venture capital market remains one of the highlights of the American economy and contributes significantly to the nation's competitive advantage. Nevertheless, some important concerns remain.

*Geography:* Venture capital investment firms tend to be geographically concentrated, with major hubs in the San Francisco Bay area and a secondary hub in and around Boston. While venture capital firms have emerged elsewhere, the most important players are located on the coasts, and the most ambitious companies seeking large investments from well known firms must typically either move to be closer to their financiers or else engineer a consortium arrangement between a local venture fund and a coast-based partner.

*Technology sector:* High tech companies are more likely to attract venture financing than other companies. This is due partly to the potential for growth that exists in technology-facing industries, but it also reflects historical patterns of investment and expertise.

*Under-represented groups:* Finally, because venture finance – particularly angel investing up through early stages of the venture capital – is highly relationship and network dependent, it disproportionately affects women and minority companies.

The SBA's Small Business Investment Companies (SBIC) program is intended to address these gaps by providing incentives for the formation of private venture funding initiatives with a mission of investing in companies that meet the above criteria. The Urban Institute's<sup>14</sup> 2008 study concluded the SBIC program has met the goal of directing investment in each of these three areas. In this respect, federal policy seems to be working relatively well but the SBIC venture program was discontinued two years ago. Given the early successes of the SBIC venture program, it makes sense to examine ways to build on the program in a manner which addresses past issues and which promotes geographic, ethnic, and technology sector

diversification. However, government funding may have more of a positive impact if it is targeted toward basic research and R&D. The new administration has increased basic R&D funding, which is very important. Moreover, basic government functions like patent protection and rule of law are fundamentally working well.

### **Priorities: Access to Capital**

- Within the first year:
  - The Administration should continue to take immediate action to ensure the liquidity of capital markets for loans to small and medium-sized companies.
  - It should also continue to act to head off any problems that may arise with respect to a tightening of revolving credit.
- Within the first two years:
  - The Administration should work with Congress to examine the implications that a change in individual tax rates would have on the likelihood of owners of small and medium-sized companies to invest profits back into their companies. In particular, it should explore the feasibility of providing preferred tax treatment to profits that are reinvested but with the paramount goal of ensuring relative parity among companies incorporated under different chapters of the tax code.
- Within the first term:
  - Re-examine the SBA loan guarantees program with an eye toward effectiveness. Increasing sophistication of credit markets has addressed many of the market failures that the program was originally intended to overcome. However, certain market failures remain and, at the same time, the program could be more effectively used to provide incentives for needed investments in upgrading technology and utilization of programs intended to help companies compete more effectively in the global economy.
  - The government should generally fund fewer programs facilitating venture capital, while directing more support toward entrepreneurs and entrepreneurial culture.

## **IV. Regulation and Representation in Government**

The concerns of small and medium-sized companies within government are shepherded by the Department of Commerce's Small Business Administration. However, as the economic crisis has become a more urgent policy concern, it has become clear that the voices of smaller companies are needed in a wide range of government bodies. The SBA has been called on to provide input and, in some cases, to provide formal representation throughout the government's economic policy apparatus. This role, and the need for inter-departmental coordination on issues pertaining to smaller companies, should be re-examined and, in some cases, formally institutionalized. Specifically, the SBA should have a permanent seat on the President's Council of Economic Advisors as well as within the office of the Office of the U.S. Trade Representative. This constituency should also have representation on government boards tasked with enhancing the ability of U.S. companies to engage with global markets as well as with enhancing the nation's innovative capacity.

At the same time, it is important to remain diligent concerning the regulatory issues affecting small and medium-sized companies. The SBA has instituted an annual practice of identifying ten regulatory requirements affecting small businesses by various federal agencies for revision and reform. The rules are chosen on the basis of several factors: (1) whether the rule could reasonably be tailored to accomplish its intended objectives while reducing the impact on small businesses or small communities; (2) whether the rule being nominated has ever been reviewed for its impact on small entities; (3) whether technology, economic conditions, or other factors have changed since the rule was originally written; (4) whether the

rule imposes duplicative requirements; and (5) the overall importance of the rule to small businesses and small communities. This program has identified a number of important regulatory issues and has been effective at working with agencies to resolve these issues. This program should be continued and supported.

### **Priorities for Representational and Regulatory Reform**

- Within the first two years:
  - Representation of small and medium-sized businesses on boards affecting international trade and innovation should be examined and improved where found to be lacking.
- Within the first term:
  - A permanent representative role for small and medium-sized businesses' should be institutionalized on major government bodies, including the President's Council of Economic Advisors.

# **Endnotes**

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<sup>1</sup> The chart above reflects data from the monthly ADP Employment Report, tracking job loss/gain by firm size from May 2005 to May 2009.

<sup>2</sup> *Employer Health Benefits: 2008 Annual Survey*, Kaiser Family Foundation, 2008 <http://ehbs.kff.org/pdf/7790.pdf>

<sup>3</sup> *Fewer employers offer health benefits: study*. Reuters, May 1, 2007.

<http://www.reuters.com/article/healthNews/idUSN3047454220070501>

<sup>4</sup> *Employer Health Benefits: 2008 Annual Survey*, Kaiser Family Foundation, 2008 <http://ehbs.kff.org/pdf/7790.pdf>

<sup>5</sup> *GAO-09-363R State Small Group Health Insurance Markets*, GAO, February 27, 2009

<http://www.gao.gov/new.items/d09363r.pdf>

<sup>6</sup> *Health Insurance Coverage*, National Coalition on Health Care. <http://www.nchc.org/facts/coverage.shtml>

<sup>7</sup> *Knowledge Economy Immigration: A Priority for US Growth Policy*, Tim Kane and Robert Litan, Kauffman Foundation, April 30, 2009 <http://www.kauffman.org/research-and-policy/knowledge-economy-immigration-a-priority-for-us-growth-policy.aspx>

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