Impact of FY 2004 Budget on Small Business

A report prepared by

House Small Business Committee Democratic Staff

Nydia M. Velázquez , Ranking Democratic Member

March 18, 2003

Introduction

The federal budget provides a blueprint for every agency, and all the programs contained within these entities. Our fiscal spending is approximately $2.1 trillion annually, and includes the 15 agencies within the executive branch, and all other federal government operations.

The budget drives the priorities of our nation. It accomplishes this by designating funding levels and determining which programs address critical issues in the opinion of the budget's drafters. It decides the programs that should be fully funded or invested in, and those that need less investment or outright termination.

Done correctly, our budget priorities ensure economic growth and stability, while adding in safeguards to protect the most vulnerable communities. If budget priorities are erroneously, improperly or hastily selected, it can have a devastating effect on this country, including rising deficits, depleted Medicare and Social Security trust funds, and a severe lack of important social and business programs that bring growth and development to underserved areas across the United States.

The FY 2004 budget is especially critical as our nation tries to weather the current economic downturn. Today, the U.S. faces the weakest economic growth under a president in 50 years, growing at a rate of only 2.4% in 2002. According to the Bureau of Labor Statistics, the economy has lost nearly 2.3 million jobs since 2001. The U.S. economy faces the worst hiring slump in 20 years, with the latest unemployment rate hovering at 6%. Many of those who are unemployed have been looking at least six months for work, triple the number of months two years ago.

It is small business that can offer these workers alternatives – and jobs – as the lifeline of the American economy. Small businesses create 75% of all new employment opportunities and make up 99% of all employers. The more than 25 million small businesses in America provide almost half of all sales in this country and constitute half of our GDP.

It is in difficult times that small businesses can make a difference. A particular strength of small businesses is their ability to respond to sharp changes in economic conditions. In fact, contrary to popular belief, start-up businesses flourish when the economy flounders. Sixteen of the 30 corporations on the Dow Jones industrial average actually trace their birth to recessions. Such famous corporations as Microsoft, Hewlett-Packard and Disney all started in times of recession.

During the last recession of the early 1990s, one-quarter of all laid-off managers over the age of 40 started their own companies. In that recession, small businesses created almost 4 million jobs, and they outpaced corporate growth by nearly 500,000 jobs. Small businesses can once again play a major role in helping our economy to rebound, but only if given the proper tools and resources.

Unfortunately, President Bush's FY 2004 budget submission and the subsequent Congressional budget resolution do little to provide adequate funding to support this nation's small businesses. Instead, it places a priority on a massive tax cut, much of which will provide no relief to small firms. In this budget, the bulk of the tax cut is the "jobs and growth package" aimed at repealing the double taxation on corporate dividends and accelerating the tax cuts of 2001.

These tax proposals fail to address the needs of small businesses. The tax cuts, which will cost an estimated $674 billion, have earmarked only 3%, or $18 billion, in targeted relief for small businesses. In addition, the dividend tax repeal, making up over half of the overall cost, increases investment in large corporations over small businesses and expands tax breaks for the wealthiest Americans who receive these dividends. The repeal of the dividend tax cut and overall cost of the plan will have a negative impact on investment in small businesses and their ability to access capital.

Not only will small businesses receive little or no real benefit under the president's stimulus plan, but because of the tax policy of the Bush administration and House Republicans, which has resulted in a $1.8 trillion deficit, they have made the choice to make sweeping and deep budgetary cuts. While in times of high budgetary deficit fiscal constraint is in order, the decision to focus so many of these cuts on programs that assist small businesses and provide economic growth demonstrate a disconnect between the administration backed by House Republicans and the real needs of this nation's economy.

The following is a report prepared by the Democratic staff of the House Small Business Committee examining the impact of the FY 2004 budget, including the tax cut, on small business. The report details deep cuts to 24 federal programs that fill critical gaps for this nation's small businesses that, because of cost or size, are unable to get assistance elsewhere. Many times, it is these federal programs that give small businesses and entrepreneurs the final ingredient necessary for success. By failing to help small businesses – whether it be in the tax proposal, or the cuts to federal programs the tax cut has spurred – this budget jeopardizes the possible recovery of our economy because of misplaced priorities that may worsen the current economic downturn.

Cuts to Federal Programs

Advanced Technology Program (ATP)

Small businesses are this nation's leaders in new ideas, accounting for 55% of all innovations. In an effort to support their innovative savvy, the Advanced Technology Program (ATP) works to bridge the gap between the research lab and the marketplace, stimulating prosperity through innovation. This unique government-industry partnership accelerates the development of emerging or enabling technologies for the creation of revolutionary new products, industrial processes and services that can compete in today's rapidly changing world markets. ATP challenges industries to take on higher-risk projects with commensurately higher potential payoff and provides multi-year funding to single companies and industry-led joint ventures. To date, more than half of the ATP awards have gone to small businesses or joint ventures led by small enterprise. Since ATP will be terminated, small businesses will lack the support they need to develop and grow new ideas that lead to innovative new products and services thereby enhancing their global competitiveness.

Appalachian Regional Commission (ARC)

Appalachia, home to more than 23 million people, is struggling to achieve better economic health and stability. While the region showed strong growth in the early 1990s, its economy began to slip between 1995 and 1999, leaving Appalachia with a per capita income of only 81.9% of the U.S. average. The efforts of small, homegrown businesses play an integral role in creating self-sustaining local economies and improving the quality of life in Appalachia. Through programs like its Entrepreneurship Initiative and Business Development Revolving Loan Fund, the Appalachian Regional Commission (ARC) works with the people of Appalachia to create opportunities for self-sustaining economic development and improved quality of life. Each year ARC provides funding for several hundred projects throughout the 13 Appalachian states in support of economic and human development, bringing more of Appalachia's people into America's economic mainstream. The ARC's Entrepreneurship Initiative provides communities with tools to assist entrepreneurs in starting and expanding local businesses by giving entrepreneurs greater access to capital, educating and training entrepreneurs, encouraging sector-based strategies to maximize the economic strengths of local communities, and providing strategic support for business incubators. Through its Business Development Revolving Loan Fund, ARC addresses the problem of credit availability that so often impedes small business development. ARC programs create thousands of new jobs and provide technical, managerial, and marketing assistance to emerging new businesses. With a 50% cut in funding, ARC will be unable to fully serve some of our nation's most economically distressed counties.

Bureau of Apprenticeship and Training (BAT)

Even given the current recession, the service, technical, contracting, auto, and manufacturing industries are experiencing a serious shortage of qualified job candidates. Within these industries, small businesses are searching to strengthen their ranks, and one way to do this is through apprentices. The Bureau of Apprenticeship and Training (BAT) stimulates and assists such industries in developing and improving apprenticeship and other training programs created to provide the skilled workers needed to compete in a global economy. It registers apprenticeship programs and apprentices in 23 states, and assists and oversees State Apprenticeship Councils (SACs), which perform these functions in 27 states, the District of Columbia, Puerto Rico, and the Virgin Islands. Apprentices make up a loyal and skilled employee base for many small businesses that are then able to increase their bottom line through the practical skills and know-how of these individuals. Apprentices also have lower turnover rates and reduced worker compensation claims. The BAT cuts will inevitably impact the ability of small businesses to take advantage of the benefits that come with hiring apprentices and incorporating them into their ranks.

Clean Air Act Section 507 – Small Business Stationary Source Technical and Environmental Compliance Assistance Program

Compliance with federal regulations is one of the most difficult challenges facing small business. Unlike large corporations, small businesses often cannot afford the attorneys or technical advisors needed to ensure they are complying with laws and, therefore, are not always aware of their non-compliance. One of the most complex set of regulations small businesses must comply with are those laid out under the Clean Air Act (CAA). Section 507 of this act created state Small Business Stationary Source Technical and Environmental Compliance Assistance Programs (SBTCPs) to assist small businesses with CAA compliance. The SBTCP's Small Business Assistance Program (SBAP) provides small businesses with free technical assistance grants that help them understand the regulations and create strategies for complying. Without this funding, small businesses will be need to spend money on fines for non-compliance or hire costly outside consulting services to help them navigate the complicated CAA regulations process.

Community Development Financial Institutions (CDFI)

Many times businesses in the communities that most need credit are unable to get it. Ignored or abandoned by conventional financial institutions, many of them lack economic development opportunities and are forced into decline. The Community Development Financial Institutions (CDFI) program has awarded more than $534 million to community development organizations and financial institutions for the expansion of credit availability, investment capital, and financial services in distressed urban and rural communities. These CDFIs provide a wide range of financial products and services, including commercial loans and investments to start-up or expand small businesses and financial services in low-income communities. In addition, these institutions provide services to help ensure that credit is used effectively, including technical assistance to small businesses and credit counseling to consumers. CDFIs have channeled capital to countless enterprises such as grocery stores, construction contractors and daycare providers, creating jobs and improving the standard of living in underserved communities. Through their community development loan funds, CDFIs lend to help businesses expand while community development venture capital funds provide equity and management expertise to small, minority-owned businesses that promise rapid growth. The budget cuts to CDFI funding will seriously reduce the ability of underserved communities to revitalize their local economies by providing jobs and entrepreneurial opportunities for the residents who live there.

Delta Regional Authority (DRA)

The Delta Regional Authority (DRA) is a federal-state partnership serving a 240-county/parish area throughout Alabama, Arkansas, Illinois, Kentucky, Louisiana, Mississippi, Missouri and Tennessee. Designed to remedy severe and chronic economic distress by stimulating development and fostering partnerships, the DRA is a critical service for the communities located within these states. By providing states and non-profit organizations with workforce and business development grants, DRA helps low-income communities access critical job training and entrepreneurship services. The DRA's business development services focus on fostering entrepreneurship and small business start-ups, while its job training and employment-related education programs emphasize the use of existing public educational institutions in each region. Last year the DRA received 745 applications for funding requesting a total of $255 million, yet funding has been cut to just $2 million from the $30 million previously authorized. Without the small business and job training services offered by the DRA, these states would lack the meaningful projects undertaken by regional planning commissions, local governments, non-profit organizations, and universities to address chronic problems, which have led to depressed economic conditions and higher poverty rates for many residents.

Economic Development Administration (EDA)

Small businesses can breathe new life into our most vulnerable communities. The Economic Development Administration (EDA) stimulates industrial and commercial growth by generating jobs and retaining existing jobs in economically distressed areas of the United States. EDA assistance is available to rural and urban areas that are high-unemployment/low-income or in severe economic distress. These investments support a variety of specific economic development strategies including business incubators, redevelopment of Brownfields sites, and business/industrial development. EDA provides small business grants to help distressed communities attract new industry, encourage business expansion, diversify local economies, and generate long-term private jobs. Successful economic development projects attract private-sector capital investment and create value-added jobs. Investing in successful undertakings, creating jobs, and expanding the economy decreases the demand for government expenditures for social services and tax revenue increases. The cuts to EDA significantly reduces its impact and lessens its ability to capitalize on the rich resources small businesses can offer to reviving communities in need.

Economic Development Initiative (EDI)

The Economic Development Initiative (EDI) provides grants to local governments that can be used to enhance both the soundness of loans guaranteed through the Department of Housing and Urban Development's Section 108 Loan Program and the feasibility of the large economic development and revitalization projects they finance. Because local governments pledge against potential repayment shortfalls with these loans, the EDI program offers communities a way to decrease their risk. The goal of EDI is to provide tax breaks and incentives to attract private investment and create jobs. Increasing access to capital for entrepreneurs and small businesses has emerged as key components of the job growth and investment strategy powered by the EDI grant program. It does this by enabling communities to obtain long-term, low-interest HUD loans for up to ten times the amount of their EDI grants for a wide range of economic and community development projects. Since 1994, HUD has awarded $500 million in EDI grants and has committed more than $4 billion in guaranteed loans, generating an estimated 300,000 jobs. Zeroing out this program will severely impact the ability of small businesses across the country to access capital, hindering job growth, economic development and community revitalization.

Employment Service – One-Stop Career Centers

The Employment Service system has provided high quality job seeker and employer labor exchange services and information for over 60 years. Through One-Stop Career Centers, the Employment Service has fulfilled the employment-related information and service needs of millions nationwide. Working out of tight quarters with small staffs and without the benefit of the Human Resource Departments large corporations have, small businesses face obstacles when recruiting and interviewing new employees. Through its One-Stop Career Centers, the Employment Service offers small business employers assistance from the initial placement of a job announcement to the final interview process. These local centers help small businesses craft their job descriptions so they can best target the type of employees they need, and provide interview space for those small firms that lack office space. They also offer phone, fax and Internet services for start-up entrepreneurs who do not yet have office space. For established small businesses, the Employment Service One-Stop Career Centers offer meeting space as well. The services One-Stop Career Centers offer job seekers include occupational skills training, on-the-job training, entrepreneurial training, skill upgrading, job readiness training, and adult education and literacy activities. These centers help to provide small businesses with a more skilled workforce and also help to peak interest in entrepreneurship, giving rise to a cadre of future small business owners. As small business owners face formidable challenges in setting aside money for employee training, which can cost from $250 an hour to a staggering $10,000 a day, these centers provide a crucial service by providing them with a trained, skilled workforce. The Employment Service fills a critical gap for small businesses that do not have the infrastructure or the capital to support or offer things such as meeting spaces, training services and human resources expertise. The elimination of this program will cripple its ability to effectively provide employee-employer support to countless small businesses.

Empowerment Zones (Round III)

Opportunities for entrepreneurial initiatives, small business expansion, and job training which offer upward mobility are critical to providing economic opportunity and direction for underserved areas and distressed neighborhoods. Through the creation of Empowerment Zones (EZs) in this nation's most distressed urban communities, economic development is encouraged through public-private partnerships. The new urban EZs receive regulatory relief and tax breaks to help local businesses provide jobs and promote community revitalization. EZs encourage and assist small business development through tax incentives, mentoring programs which pair small businesses with large ones, and crucial funding to provide individual businesses with ideas to help them with their development. The creation of jobs by small businesses in EZ communities provides the foundation for residents to become economically self-sufficient while spurring development. EZ employers are even entitled to a 20% credit on the first $15,000 of wages paid to certain qualified zone employees. Small businesses in Empowerment Zones, benefit from employment credits, increased IRC Section 179 deductions, rollover of gain from the sale of Empowerment Zone assets, increased exclusion of gain from qualified small business stock and tax-exempt bond financing. With the economy in a slump, and poor communities being the hardest hit, zeroing out EZs will negate years of work in helping underserved areas of this country to survive.

Energy Star Program
Small businesses in the U.S. now account for more than half of all energy consumption in North America. Their growth and development depends on an affordable – and reliable – energy supply. The Energy Star Program was introduced by the U.S. Environmental Protection Agency (EPA) in 1992 as a voluntary labeling program designed to identify energy-efficient products in order to reduce carbon dioxide emissions. EPA then partnered with the U.S. Department of Energy in 1996 to promote the Energy Star label, with each agency taking responsibility for particular product categories. Energy Star has since expanded to cover new homes in the buildings sector, residential heating and cooling equipment, major appliances, office equipment, lighting, consumer electronics, and other product areas. It helps businesses by establishing an energy performance target for new building design, providing a benchmarking tool for buildings that allows businesses to compare their energy costs to those of similar organizations. It also measures building energy consumption to help small businesses improve their bottom line through increased energy and environmental performance. Without the crucial services of the Energy Star Program, many small businesses would suffer losses due to wasteful energy systems and prohibitively high energy costs.

Export-Import Bank Medium-Term Export Credit Insurance
The focus of international business is typically on corporate giants, but it is small businesses that represent 96% of all exporters. Yet small businesses still face barriers to penetrating the competitive global marketplace. The Export-Import Bank, the chief U.S. government agency tasked with financing American exports, offers important services to help small business remain competitive overseas. For example, the bank offers Medium-Term Export Credit Insurance, a valuable marketing tool for small business exporters, which allows them to offer credit terms ranging from 1-7 years repayment to their customers, with the commercial and political risks of default covered 100% by the Ex-Im Bank. Furthermore, this program provides small businesses with two additional benefits – it protects them from payment default by their foreign buyers and it gives them the opportunity to get paid in full for their exports upon shipment. In restructuring the Ex-Im Bank and zeroing out this program, many small businesses that are unable to take on the risks associated with international trade will be unable to expand overseas and will miss out on foreign markets and opportunities for growth.

Export-Import Bank Working Capital Guarantee Program
Lack of capital prevents small businesses from expanding internationally as local banks are reluctant to make loans to them since they lack the collateral or securities. It is the Working Capital Guarantee Program at the Ex-Im Bank that helps small business solve this dilemma by providing repayment guarantees to lenders on secured, short-term working capital loans. This program enables commercial lenders to make working capital loans to U.S. exporters for various export-related activities by substantially reducing the risks associated with such loans. The

Working Capital Guarantee Program is designed to help small businesses overcome the working capital barrier. The exporter may use the program to purchase raw materials and finished goods for export, pay for materials, labor and overhead to produce goods for export, and cover stand-by letters of credit, and bid and performance bonds. This program enables commercial lenders to make working capital loans to U.S. small businesses for various export-related activities by substantially reducing the risks associated with such loans. The elimination of this program prevents small exporters from tapping into an important source of capital to fund their overseas ventures, and leaves them with few alternatives of finding such funds elsewhere.

Minority Business Development Agency (MBDA)
One of the fastest growing small business sectors are minority-owned firms. Minority-owned businesses are growing at a rate four times that of the national average for small businesses, they employ 4.5 million workers, generate $591 billion in annual revenues, and accounted for 15 percent of all private U.S. firms in 2002. The Minority Business Development Agency (MBDA) was specifically created to encourage the creation, growth and expansion of minority-owned businesses in the United States. MBDA promotes the growth and competitiveness of minority-owned businesses by providing access to public/private debt and equity financing, market opportunities, and management and business information by coordinating and leveraging public and private resources and facilitating strategic alliances. MBDA also focuses on international trade, franchising, and minority supplier corporate development. Through its minority matchmaker program in international trade, it operates as a mentor-protégé program. Also operating as a mentor-protégé program is the minority supplier corporate development program that involves the referral of firms in the middle- to upper-level of growth to Fortune 1000 corporations. Finally, MBDA also assists minority entrepreneurs interested in franchising by facilitating partnerships with fast food giants including, McDonald's and Burger King. The cuts to this program will make it more difficult for this critical sector to grow and contribute to our nation's financial recovery.

National Community Development Initiative (NCDI)
A new driving force in this country's economy – and the anchor of many communities – is minority enterprise. Many times, minority-owned companies face obstacles to finding the capital they need to start-up and grow. The National Community Development Initiative (NCDI) provides millions in grants and loans – with some of these funds used to create a line of equity for minority-owned firms – to nonprofit organizations and community development corporations. The Community Development Corporations (CDCs) that make up the NCDI address pressing business issues including job creation, training, and placement needs within their communities. CDCs borrow money, invest it in the physical and social infrastructure of their neighborhoods, and repay their debts. They act as competent local entrepreneurs that help residents gain a decisive voice and economic stake in their communities. Without the NCDI grants and loans, the local CDCs will be unable to foster small business growth and development, which in turn spurs job creation and economic stability where it is needed most.

Manufacturing Extension Partnership (MEP)
The manufacturing sector has been in steep decline since the beginning of 2000, with a net loss of more that 1.9 million factory jobs. Many small manufacturers are in need of assistance to help them weather the current economic slump. The Manufacturing Extension Program (MEP), a

network of not-for-profit centers in over 400 locations nationwide, helps sustain entrepreneurial development by providing small and medium-sized manufacturers with technical and business solutions. MEP aids these businesses with process improvement, quality management systems, business management systems, human resource development, market development, materials engineering, plant layout, product development, energy audits, environmental studies, financial planning and electronic commerce. Operating in all 50 states and Puerto Rico, MEP has made it possible for approximately 150,000 of our nation's smallest firms to tap into the expertise of knowledgeable manufacturing and business specialists all over the United States. Since its inception in 1989, manufacturers that utilized MEP's services have seen nearly $2.3 billion in new or retained sales, $482 million in cost savings, and $873 million in new investment. Given the loss of manufacturing jobs, the MEP is needed now more than ever, yet the funding provided will be used to close the program. Without these centers, small manufacturers will continue to experience dipping revenues, additional lay offs, and possibly even closings of facilities.

National Telecommunications and Information Administration (NTIA)
Affordable access to telecommunications is a basic necessity in all sectors of our economy, including the growing small business sector. As more and more small businesses take advantage of electronic commerce, the National Telecommunications and Information Administration (NTIA) provides the vital support they need by resolving privacy, content regulation, copyright protection, taxation and other technology-related issues. As the principal voice of the executive branch on domestic and international telecommunications and information technology issues, NTIA works to spur innovation, encourage competition, and help create jobs while providing consumers with more choices and better quality telecommunications products and services at lower prices. Small businesses are increasingly taking advantage of technology and support services as personal computers, fax machines, laser printers, Internet access, scanners, cellular telephones, and other telecommunication services provide powerful and inexpensive ways to work independently, yet stay connected to the world from a home office or small business. The common availability of sophisticated technology that was previously only affordable in a corporate environment has leveled the playing field between big and small companies. Technology has given small businesses the power to operate efficiently from virtually any location. In 2000, small businesses spent approximately $88 billion for telecom products, enhanced services, and Internet access and that figure will likely increase to upwards of $120 billion by 2005. Funding to NTIA has been allotted to close out the program. Without NTIA to provide small businesses with telecommunications industry information, our nation's entrepreneurs will undoubtedly find it hard to continue to thrive and grow their businesses using technology.

Northern Great Plains Regional Authority
Small businesses understand that economic strength and prosperity are generated at the regional level. Building on this principle, the Northern Great Plains Regional Authority was created as part of the 2002 Farm Bill to serve the states of Iowa, Minnesota, Nebraska, North Dakota and South Dakota through economic development projects. Authorized at $30 million per year, it would provide grants to states and public and nonprofit entities for business development and entrepreneurship, job training, and local development districts. Like the Delta Regional Authority and the Appalachian Regional Commission, this program would provide much-needed economic assistance and business development opportunities to rural, distressed communities by

funding regional, state and local initiatives. Unfortunately, President Bush's budget did not include any funding for this program that would play a vital role in the economic renewal of the Great Plains region and would have provided countless small business owners with access to business development services.

Small Business Administration (SBA) Entrepreneurial Development Programs
With Corporate America shedding jobs and a tight employment market, many individuals will look to starting their own business venture as an alternative. In fact, during the early 1990s, over one-quarter of managers who were laid-off started their own businesses. While many of these individuals have the technical ability in their fields, they lack the general business knowledge to turn their ideas into profitable business ventures. To assist in this area, a myriad of entrepreneurial development programs exist. Study after study has shown that entrepreneurs who receive such assistance are twice as likely to succeed. Now, these individuals will not be able to count on the support they have received in the past because of budget cuts. Programs like the Women's Business Centers, which not only aid one of the fastest growing sectors of the economy – women entrepreneurs, but also help low-income women and welfare recipients start businesses, are severely under funded. The largest entrepreneurial network, the Small Business Development Centers (SBDCs), have also been left without adequate funding. The level provided by the administration is below last year's appropriation level and is compounded by funding shortfalls and cuts by states due to their current fiscal crises. Entrepreneurial development programs like the SBDCs are critical in times of economic downturns, and this particular initiative yields a return of two investment dollars to the economy for every federal dollar spent. The failure to adequately fund entrepreneurial development programs will result in less economic growth, higher unemployment rates, and a loss of treasury revenue, which are all critical components to helping turn around our current economic state.

Small Business Administration (SBA) Government Contracting
The $220 billion federal marketplace – the largest in the world – is one of the best ways for small businesses to expand and create jobs. The federal contracting arena should hold great potential for small firms, but there are significant barriers that block them from accessing their fair share of contracting opportunities. Federal laws exist that are designed to ensure open and equal access for small businesses, but many times federal agencies fail to comply with these laws. Agencies are then unable to provide opportunities for small firms or may not realize the requirements to do so, in large part, due to lack of enforcement of small business protection laws. Unfortunately, the administration has not adequately funded the ranks of enforcement officers who ensure that federal agencies comply with contracting small business laws already on the books. When government contracting opportunities for small firms do exist, the playing field is uneven. Several programs provide assistance to firms that have historically been left out of the federal market. Important technical assistance programs, and business development tools for women, minority business owners, and firms located in low-income communities, have also seen funding cuts, pushing these businesses further out of the market. In short, adequate funding has not been provided to either assist in the enforcement of existing laws, or to provide the necessary assistance to under-represented companies that would allow them to win more federal contracts. These cuts to enforcement and increased assistance to encourage participation will undoubtedly cost small businesses billions in lost contracting opportunities.

Small Business Administration (SBA) Loan Programs

One of the most important components to economic recovery is to provide small business with a capital infusion. Unfortunately, many conventional forms of capital are often out of reach for small business. Today, the number one method for financing a business is credit cards, usually carrying very high interest rates. In addition, only 2% of all venture capital is funneled to this nation's small firms. Filling this financing vacuum are the SBA loan programs. Through public-private partnerships that share the lending risk, small businesses are able to tap into capital that is both affordable – and accessible. In these programs last year, $20 billion in capital, accounting for 40% of all long-term small business lending, was provided to this nation's entrepreneurs. Due to a combination of budget cuts and policies that are overcharging or taxing small businesses that use the SBA programs, they will lose over $4 billion in lending opportunities. This will limit the economic growth and job creation driven by this nation's small firms.

Small Business Administration (SBA) Programs for Low-Income Communities

Even during the economic boom of the 1990s, pockets of poverty still existed across the country that did not benefit from this period of expansion. With the current recession, these communities have only slipped further into poverty. Unfortunately, many of the economic development tools to aid businesses in low-income communities have suffered some of the most severe cuts. One of the greatest challenges for small businesses in these areas is to find capital. This is only made more difficult when the Microloan Program that provides seed capital to budding entrepreneurs is cut in half and the New Markets Venture Capital Program, the only equity capital program that teams with technical assistance to provide investments into low-income communities, fails to be funded at all. The BusinessLINC Program, which opens up emerging domestic markets to small businesses in low-income communities, has also received no funding. The budget also fails to provide funding for critical programs like PRIME and One Stop Capital Shops for the development of business and economic opportunities in low-income areas. By refusing to fund these programs, the budget not only deprives some of our neediest communities of economic assistance, but it fails to take advantage of the opportunity to provide the little investment needed to return huge benefits in areas plagued by poverty across the country.

Temporary Assistance for Needy Families (TANF)

While it is critical to move individuals from welfare to work, the benefits of moving people to self-sufficiency through business ownership are often overlooked. One of the many services provided through the Temporary Assistance for Needy Assistance (TANF) program is support for microenterprise development – a small business development model for welfare recipients. TANF recipients that participate in the microenterprise development programs have found that owning a small business enables them to better balance home and work requirements, build on services they already informally provide to their communities, and create jobs for other low-income residents. Approximately 7% of TANF recipients choose self-employment and successfully start and operate a business, creating, on average, 1.5 jobs for other low-income community members. Unfortunately, the great potential that microenterprise development holds to help low-income individuals move towards economic self-sufficiency through owning a small business will not be reached. The administration's failure to adequately fund TANF coupled with the fiscal crisis, which has forced states to reduce funding to the program, will result in a great loss for TANF recipients. At a time when the focus should be on creating opportunities for low-income individuals through initiatives like small business ownership, the latest budget will, instead, inhibit the ability of TANF recipients to look to small business as a way to reduce their dependency, continuing the cycle of poverty in low-income communities.

Workforce Investment Act (WIA) Adult Training Programs
According to the Bureau of Labor Statistics, occupations requiring a vocational degree, which accounted for 29% of all jobs in 2000, will account for 42% of total job growth from 2000 to 2010. This trend will be particularly burdensome for small business owners who do not have the time or the network to conduct personnel searches, or the resources to lure skilled workers away from larger companies with higher salaries and better benefits. The purpose of adult programs under Title 1 of the Workforce Investment Act (WIA) is to provide workforce investment activities that increase employment retention and earnings and occupational skill attainment of participants. These programs aim to improve the quality of the workforce, reduce welfare dependency, and enhance the productivity and competitiveness of our nation's economy through comprehensive training tailored to community and employer needs. Small business owners depend on the Adult Training Programs for a skilled employee pool. Without it, many small firms will see their revenue shrink as they are forced to spend critical funds on training programs to get the skilled labor force they need for success.

Tax Reforms in FY 2004 Budget

One of the major tools of fiscal policymaking is tax reform. Effective tax policy can be used to speed up business growth and encourage investment. Tax policy must also balance these goals against the overall budget impact since the creation of large budget deficits can impede economic expansion and growth. The desired result is to create tax policy that reduces the tax burden but increases overall government revenues by creating growth in the taxable base.

Tax reforms can aid entrepreneurs in three ways – the decision to launch a new business, the ease of finding financing, and the decision to expand. In shaping broad tax policy designed to stimulate entrepreneurial activity, policymakers must be reactive to reforms that have been successful in the past as well as the economic conditions that exist. The following is an analysis of the small business tax reforms, particularly the "economic growth package," contained in the FY 2004 budget and their impact on small businesses.

History of Failed Policies for Small Business Growth: 2001 Tax Cut and 2002 Stimulus Package

The proposed reforms contained in the FY 2004 budget are very much an extension of the 2001 tax cut and 2002 stimulus package that were passed into law. The centerpiece of the 2001 tax cut was the reduction of the marginal tax rates and complete elimination of the estate tax. Due to the high cost of these provisions, the cuts were not made permanent due to the impact on the federal budget. Currently, these tax cuts are scheduled to expire in 2011. The entire package that passed as part of the 2001 tax cuts cost $1.3 trillion over 10 years.

After the 2001 reforms passed and the economy continued to sputter, businesses in America clamored for the need of an additional stimulus package which would include targeted relief for small businesses. An initial 2002 stimulus package that was put together by legislators to address these problems included targeted tax cuts and investment incentives that were aimed at small businesses. These provisions included an increase in the amount that small businesses could deduct for equipment expenditures and deduction for start-up costs of a pension plan, among other proposals. However, when the stimulus package was re-worked and passed into law, many of these proposals were not deemed as priorities and were dropped or severely reduced. In the end, 13 million small businesses saw no relief from this bill. (*For additional statistics, see chart in appendix: 2002 Stimulus Package Proposed Changes v. Final Bill.)*

The tax cut of 2001 and the 2002 stimulus package did not provide small businesses with the capital infusion they needed. As a result, there have been 2.3 million jobs lost since 2001 and the economic growth for small businesses has stagnated. Due to the failures of these economic growth plans, small businesses are still struggling and additional targeted reforms are needed to address their problems in ways that the previous two growth packages have failed. Since the growth expected did not occur, it has also caused the overall tax revenues to fall with an estimated budget shortfall of at least $300 billion in 2003. The FY 2004 budget does include a number of tax reforms, but most of these again fail to adequately address the needs of small businesses.

FY 2004 Budget Economic Growth Package

The primary focus of the tax reforms known as the "economic growth package" in the FY 2004 budget is aimed at promoting growth for large corporations. The main provisions call for the acceleration of the 2001 tax cuts, elimination of the double taxation on corporate earnings, and providing some relief to individuals. The "package" also calls for increased expensing deductions for small businesses – something the small business community has been demanding since the start of the recession – but does little else to help small businesses. Nearly half of the package or $385 billion is aimed at repealing the "double taxation" of dividends and is designed to provide a boost in the large corporations that could issue these dividends. Below is a breakdown of the provisions and the effect that they will have on small business growth, as well as the overall impact that the FY 2004 budget will have on small businesses.

Accelerating the 2001 Tax Cuts

Since one of the major tenets of the FY 2004 budget tax cuts is accelerating the 2001 tax cuts, it has many of the same problems and shortcomings. The tax cuts in the FY 2004 budget would accelerate some, but not all, of the income tax cut provisions that were enacted in 2001 and scheduled to be implemented in the future. The accelerated items include the reduction in the top four income tax rates (from current levels of 27, 30, 35 and 38.6% to 25, 28, 33 and 35%, respectively), marriage penalty for middle- and upper-income households, an increase in the child credit to $1,000, and expansion and indexation of the 10% tax bracket. The budget also calls for making these cuts permanent.

As the 2001 tax cut failed to stimulate small business growth, the acceleration of these rate cuts as part of the FY 2004 budget will also have a minimal impact. The major problem is that they are not designed specifically for many small businesses, since many small business owners have lower incomes because they re-invest their profits, reducing their overall income. This puts them in lower income brackets where they see little benefit under the tax cuts included in the FY 2004 budgets. Proponents try to argue that small business owners are in the upper income brackets and will see greater tax savings.

Leading up to the passage of the 2001 tax cut, a number of statistics were cited – many of which are again being cited in support of the tax plan in the FY 2004 budget – about the effectiveness that individual rate cuts, especially at the top rates, would have on small businesses. Studies have shown, however, that these tax cuts do not provide the relief necessary to small business owners. For example, nearly a third of the tax cuts in the FY 2004 budget proposal would accrue to the top 1% of taxpayers. The problem is that most small business owners are not in the top brackets that receive these benefits. In fact, only 1% – or 180,000 – of small business owners would see a benefit from the reduction in the top tax rate.

As the 2001 cuts failed to impact small business growth, the acceleration of these tax cuts will do little to help small business owners and their employees. If the FY 2004 budget had instead revised the Earned Income Tax Credit rules, it could have provided more relief because for every small business owner who would benefit from reducing the top rate, there are 12 small business owners who receive the Earned Income Tax Credit. (*For additional statistics, see chart in appendix: Marginal Tax Cut Myths for Small Businesses)*

Negative Impact on Small Businesses of the Dividend Tax Cut
As noted above, the bulk of the tax cut included in the FY 2004 budget is aimed at repealing what is referred to as the "double taxation" of dividends. The dividend cut will cost $396 billion through 2013. Currently, corporations organized as C Corporations (which are generally large ones) that have a profit must pay taxes at the corporate level. When these companies pay dividends to their shareholders, the individual shareholders must also pay taxes at the individual level on the receipt of these dividends. The budget proposal seeks to repeal the tax at the individual level for dividends which are paid by companies that have already paid at the corporate level.

An overwhelming number of small businesses are sole proprietorships, Subchapter S Corporations and partnerships. They are not eligible to pay tax-free dividends under the tax cut. However, despite the fact that the dividend tax repeal is targeted at the larger corporations which pay the corporate tax rate, the dividend tax break will have a significant negative impact on small businesses. Many small business owners are going to find that not only does this overall "growth" plan fails to provide them with the necessary relief to start and expand their businesses, but that the dividend tax repeal is going to compound their problems.

Many economists have expressed their concern that "eliminating the taxation of dividends would be ineffective at stimulating the economy." If the dividend tax is repealed, it will create incentives to shift investment dollars away from small business towards these companies that can pay these dividends. The dividend proposal creates a relative advantage for investment in large corporations over small businesses. This tax cut would make stocks a more attractive investment in terms of their after-tax returns, prompting investors to pull funds out of some other investments, shifting these dollars into corporate stocks.

Eliminating dividend taxes could also pull much-needed capital away from fast-growth (non-dividend paying) companies because investors would be more drawn to mature utilities and local phone carriers that shell out the most in dividends. Thus, not only will the dividend tax repeal fail to address any needs of small businesses, it will not have the desired effect of raising the stock value of these large companies.

Small Business Expensing
The FY 2004 budget does include an increased expensing level for small businesses. Small businesses currently can deduct $25,000 for equipment purchases each year. The budget proposal calls for increasing this to a level of $75,000. This proposal has been talked about before and was included in early drafts of the 2002 stimulus package. It is exactly the type of targeted relief that will spark investment and encourage expansion of small businesses.

However, prospects for the expensing provision being included in any final stimulus package are minimal. Although, this provision makes up only 3% of the overall cost of the budget proposal, based on recent history, this provision will likely be cut from the final bill.

Long Term Effect of President Bush's Package on Small Businesses
If the final budget includes the entire tax package, the long-term effect will increase the cost of financing for small businesses. Not only does the plan threaten key investments, like Social Security and Medicare, but the growth in deficits could also promote higher interest rates and threaten to worsen the economy, instead of spurring economic growth.

The budget proposal would increase the deficit by nearly $1.3 trillion. A budget report released by the Congressional Budget Office on March 7, 2003 states that over the next 10 years "the deficit [will] persist but slowly decline, totaling roughly $1.8 trillion." The most disturbing fact of the CBO report is that it does not include the estimated costs of a war in Iraq.

Former Treasury Secretary Robert Rubin and many other economists note that increasing the federal deficit could choke off any recovery, creating a "deficit premium" that pushes up long term interest rates. Debt financing is the lifeblood for many small businesses and increased interest rates will have the effect of squeezing small business profits that might have been re-invested for growth or expansion. Small businesses are already experiencing a tighter borrowing market as the administration has already severely cut the number of government-backed small business loans.

These economists recognize that the size of the FY 2004 budget is going to create downward pressure on the economy. Its cost over the next decade and beyond would result in further damage to the federal budget, increasing deficits and thereby reducing national savings and imposing long-term costs on the economy. In a recent study by William Gale and Peter Orszag of the Brookings Institute, they found that "declines in budgets (or increases in budget deficits) reduce national savings and thus reduce future national income."

While the FY 2004 budget asserts that it balances the budget in the next 10 years, these budget figures fail to include adequate resources to fund a war in Iraq and address any sort of Medicare and Social Security reforms. As these programs will have to be adequately funded, the budget deficit will rise and add this pressure on national savings rates. This then begs the question: how will these budget deficits and reduced saving rates affect the growth of small businesses?

As a result of the declining savings rates, entrepreneurs will have less start-up capital. It will also limit growth as extra savings to boost future productivity and living standards deepen the supply of capital used by businesses to purchase plants and equipment. It means that entrepreneurs seeking venture capital will find that the nation as a whole has less to invest in their ideas. A decline investment leads to smaller stock of capital assets and lower economic growth in the future.

Alternative Proposals
Over 60% of Americans believe that the tax cut plan in the budget favors the wealthy. Even Federal Reserve Chairman Alan Greenspan, who testified before the Senate Banking, Housing and Urban Affairs and House Financial Services Committees, questioned the timing of this stimulus package. While numerous alternatives have been proposed that would lead to economic growth and substantial job creation at a reasonable cost to the federal budget, this expensive plan

has been presented. These alternatives are designed to promote economic recovery through small business growth while minimizing the overall impact on the budget.

These alternative proposals address the current conditions and the different imperatives for the short run and the long run. They would combine a targeted short-term stimulus package with long-term fiscal discipline. Such proposals would increase the level that small businesses can depreciate for equipment expenditures from the current one to $75,000 in 2003. These proposals also call for increased bonus depreciation from its current level of 30% to 50% to encourage small business investment in equipment and expand their businesses. It also could include an increase of deductions for meal and entertainment expenses – vital to many small businesses – from the current level of 50% to 80%.

Another reform that could lead to greater small business investment is a tax code change designed to promote Small Business Investment Corporations (SBIC). While the SBIC program has been successful in promoting small business investment, a certain tax code provision has prevented Debenture SBICs from receiving more investment. Currently, non-profit organizations such as pension funds and university endowments that invest in SBICs are subject to a tax (the Unrelated Business Income Tax (UBTI)). In contrast, these non-profit organizations are not subject to a tax for other similar investments. This difference creates a problem in raising private capital since these tax-exempt institutional investors and other charitable foundations control 60% of the capital available for investment in venture capital funds. As a result, SBICs have received considerable less investment from certain tax-exempt institutional investors due to the fact that these investors are subject to UBTI liability for SBIC investment. The companies financed by debenture SBICs are important to America's economic well-being in general and to the health of their local communities in particular.

Given the fact that the FY 2004 budget has only 3% of the overall "growth" package aimed at targeted small business tax cuts, it would do little to help small businesses. In contrast, the alternative plans would dedicate nearly a quarter of the overall package at provisions aimed specifically at small businesses. These proposals recognize past trends which have shown that during a recession, small business job creation occurs at a substantially greater rate than larger businesses.

Conclusion

It is the priorities that are outlined in the FY 2004 budget that will determine the future of the American economy – and the course of our nation. The budget, which makes up the trillion dollar fiscal spending done by our government each year, determines which federal programs receive funding and which ones are terminated. It is through this process that goals are set that affect the security, social, and economic priorities of our country.

Given the economic state of our nation, now is the time to invest in the programs that best serve our communities – and our economy. But the president's tax cut has caused a huge deficit, putting a strain on our spending resources in the upcoming year. This means that important social and economic development programs will see either cuts or closure. Many of the programs are those that help the most important sector of the American economy – small businesses. They are housed within several different government agencies and foster economic development initiatives through loan programs, workforce training, and export assistance.

During previous economic downturns, an explosion in small business growth and business start-ups has heralded recovery. Unfortunately, the FY 2004 budget seems to ignore the tenants of economic growth by proposing a policy direction that overlooks the needs of small business. In the current form, the budget will result in reversing the potential of economic recovery and signal the prospect of continued economic problems. The budget puts forth significant cuts to many of the financing, technical assistance, and business development programs serving small businesses.

Cuts to important programs are also concerning given the fiscal crisis that many states are in as they begin to curtail spending on local business assistance and economic development programs. These programs aimed at helping local businesses supplement the work normally done by the soon to be under funded federal programs. Without the assistance at the federal and state levels, small businesses will be unable to excel, continuing the economic downturn.

History has shown that stimulating small businesses -- and in turn, the economy as a whole -- occurs through a combination of targeted tax policy reforms and strategic investments. Small businesses provide the economic momentum necessary to pull this nation out of the current stagnant state of the economy. The needs of small business must be addressed in any effective budget plan; the proposed FY 2004 budget fails to assist these economic drivers and this failure will only aggravate the effects of a struggling economy.

Table 1: FY 2004 Small Business Budget Cuts

Federal Programs	**FY 2000 Request**	**FY 2001 Request**	**FY 2002 Request**	**FY 2003 Request**	**FY 2004 Request**
Advanced Technology Program (ATP)	$238.7 m	$175.5 m	$13 m	$107.9 m	$27 m *
Appalachian Regional Commission (ARC)	$66 m	$71.4 m	$66.3 m	$66.4 m	$33.1 m
Bureau of Apprenticeship and Training (BAT)	$19.6 m	$22.1 m	$21.4 m	$20.9 m	$21.5 m
Community Development Financial Institutions (CDFI)	$125 m	$125 m	$68 m	$68 m	$51 m
Delta Regional Authority (DRA)	0	$30 m	$20 m	$10 m	$2 m
Economic Development Administration (EDA)	$393 m	$437 m	$366 m	$350 m	$364 m
Economic Development Initiative (EDI)	$125 m	$100 m	0	0	0
Employment Service -- One-Stop Career Centers	$144 m	$154 m	$134 m	$113 m	$101 m
Empowerment Zones (Round III)	$150 m	$150 m	$150 m	0	0
Energy Star Program	$80.1 m	$80 m	$52.7 m	$49.8 m	$48.3 m
Export-Import Bank--Subsidy Costs	$839 m	$963 m	$633 m	$541 m	0
National Community Development Initiative (NCDI)	0	$24 m	$29 m	$25 m	$25 m
Manufacturing Extension Partnership (MEP)	$99.8 m	$114.1 m	$106.3 m	$12.9 m	$13 m *
National Telecommunications and Information Administration (NTIA)	$72.3 m	$423 m	$73 m	$44 m	$3 m *
Northern Great Plains Regional Authority	NA	NA	NA	0 **	0
Workforce Investment Act (WIA) Adult Training Programs	$955 m	$950 m	$900 m	$900 m	0

*Program terminated--funds available for close out of program only.
**Authorized at $30 million under 2002 Farm Act.

Table 2:
Additional Small Business Cuts in FY 2004 House Budget Resolution as Compared to FY 2004 Bush Request:
(category amounts in $ billions)

Functional category: Associated programs	FY2004 Bush Request	FY2004 H.Bud.Res.	Difference
Function 300 — Natural Resources and Environment Energy Star Program Clean Air Act Section 507 - Small Business Stationary Source Technical and Environmental Compliance Assistance Program	$30.400	$29.237	- $1.163
Function 370 — Commerce and Housing Credit Minority Business Development Agency National Institute of Standards and Technology Advanced Technology Program Manufacturing Extension Partnership National Telecommunications and Information Administration	$9.575	$7.201	- $2.374
Function 500 — Education, Training, Employment, and Social Services Bureau of Apprenticeship and Training Adult Training Programs, WIA	$86.002	$84.744	- $1.258
Function 600 —Income Security Temporary Assistance for Needy Families	$322.891	$315.939	- $6.952

Sources: Budget of the United States Government, Fiscal Year 2004, Historical Tables, Table 3.2 and Table 5.1; Fiscal Year 2004 Budget Resolution as reported by the House Budget Committee.

2002 Stimulus Package Proposed Changes v. Final Bill		
Small Business Relief	**Amount Proposed**	**Amount Delivered**
Increased Expensing Deduction for Small Business Equipment Investment	Increase expensing amount to $75,000 from $24,000	No Change
Meal and Entertainment Expense Deductions	Increase Deduction from 50% to 80%	No Change
Pension Plan Start-up Cost Deductions	$6,000 over 5 years	$1,500 over 3 years
Increase Bonus Depreciation	50% Bonus Depreciation for Equipment purchased post – 9/11	30% Bonus Depreciation for Equipment purchased post – 9/11

Marginal Tax Cut Myths for Small Businesses

Source: Center on Budget and Policy Priorities

2001/2003 Tax Cut Provisions	**Myth**	**Reality**
Top Rate Reduction	More than 17 million small business owners benefit from reducing the top rate.	Only about 1 percent – or 180,000 – of small business owners pay at the top rate.
Upper Bracket Reductions	Reducing the top rates, especially for earners over $100,000 targets small business owners	60 percent of businesses have annual revenues under $25,000
Overall Relief	Making the tax cuts of 2001 permanent would allow for small businesses to receive an average benefit of $2,042.	79 percent of returns with small business income would receive less than this $2,042 “average” amount and 52 percent would get less than $500.
Rate Reduction	Adjusting the Earned Income Tax Credit would have minimal impact on small businesses.	For every small business owner who would benefit from reducing the top rate, there are 12 small business owners who receive the Earned Income Tax Credit.