

Tax Brief

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Critiquing the “Small Business Survival Index 2003”

Overview

The Small Business Survival Committee is a Washington-based organization that seeks to create a “productive environment for small businesses and entrepreneurship.”¹ Each year, it ranks states in terms of small business survival by combining a simple sum of 21 measures into an index. The measures range from a variety of tax rates to the number of state and local bureaucrats to state crime rates. The measures chosen are arbitrary and offer no predictive value of small business survival.

This study has serious methodological flaws

The study carries out its anti-tax agenda by declaring which qualities offer small businesses the best environment for growth and sustainability. However, there is no attempt to correlate these measurements into predictive criteria. For example, data tracked by the federal government that shows actual small business survival is omitted from the study. As such, this study ignores the natural step of connecting its rankings to business survival data.

The data, which has no scientific merit, is used as a political ploy to convince legislators to greatly reduce or eliminate numerous taxes. The variables selected and the simple sum used to create the index scores have several problems that sharply reduce the legitimacy of the study’s findings. The following two sections attempt to overview these problems.

Equal Weighted Data

Formulating an index of simple sums means that all variables have an equal effect. Therefore, this study contends that the following items have the same impact:

- The presence of an inheritance, gift, or estate tax
- 1 point higher crime rate
- 1 percent higher top personal income tax rate
- 1 more bureaucrat per 100 population
- 1 point higher business liability score
- The presence of a graduated personal income tax
- 1 point higher index of per capita health care spending
- The presence of a supermajority vote (by legislators or residents) to raise or impose taxes

There is no attempt made to justify why the data are given equal weights or to justify why the variables are good predictors of small business survival.

Selected Variables Do Not Properly Measure Small Business Survival

Apart from the omission of real data, there are inherent problems with the variables that are included as well as the absence of typical data examining small business success. Of the 21 measurements, 7 deal with progressive taxes, 4 include property, sales and excise taxes, 5 concern labor costs, such as right-to-work laws and state minimum wages, and 5 measurements include miscellaneous data, such as electric or litigation

costs. The study makes no attempt to demonstrate that these measurements are reliable predictors of small business survival. Some variables are treated as having a negative impact on small businesses, when in fact the measures have little to no effect. For example, the number of bureaucrats, which includes the number of public school teachers and lunch servers, policemen, and firemen, is used as a measure of regulatory burden. Absent from the data are any measurements examining the educational level of the workforce, income levels, and quality of life data – all of which are strongly related to small business survival.

Are North Carolina's small businesses surviving?

Though the Survival Index ignores real survival data, this information is readily available. The June 2003 report from the Office of Advocacy of the US Small Business Administration shows that North Carolina's small businesses are performing well nationally. While North Carolina has ranked 37th in the nation for the past two years on the Survival Index, the survivability of actual businesses in North Carolina is quite strong. From 1990-2002, North Carolina ranked 6th in the nation on the total number of employer firms, 11th on the number of employer firm formations, and 38th on the number of firm terminations. In addition, North Carolina performed better in each ranking than every neighbor state. ⁱⁱ

What types of states score well on the Survival Index?

The Survival Index greatly rewards tax regressivity. States wanting to improve their standing can follow the same tax philosophy as the top 10 states from the index:

- Do not impose a variety of taxes. Throw out the notion that an equitable tax structure is composed of several taxes aimed at spreading the tax burden among taxpayers. Rather, this index rewards states that have high property, sales, gross receipts, and excise taxes as long as the states do not impose an individual or corporate income tax. Of the top ten states:
 - o Eight states do not tax personal income. There are only nine states without a personal income tax.
 - o Eight states do not impose an estate, inheritance, or gift tax.
 - o All nine states with no capital gains tax are in the top ten.
 - o All four states with no corporate income tax are in the top ten.

- Do not implement graduated personal income taxes. Instead, adopt a "one tax fits all" approach. The study includes measures for personal and corporate income tax rates and a yes/no variable to identify states with personal and corporate alternative minimum taxes. In addition, the study includes a yes/no variable for states offering a progressive personal income tax, which is treated negatively. Are we to assume that the progressivity of the corporate income tax doesn't affect small businesses since it is not a variable? Of the top ten states:
 - o The same eight states with no personal income tax obviously scored well in the measurement signifying an absence of a graduated personal income tax.

Conclusion

The Survival Index uses arbitrary and politically motivated criteria and makes no attempt to tie its findings to the performance of small businesses. In reality, North Carolina's small businesses are performing well compared to the rest of the nation. The measurements used by the Survival Index are used to support the organization's anti-tax agenda and do not predict business success.

ⁱ Small Business Survival Committee, Available at: <http://www.sbsc.org>

ⁱⁱ Small Business Economic Indicators for 2002, Office of Advocacy of the U.S. Small Business Administration, June 2003. The full study can be accessed at: <http://www.sba.gov/advo/stats/sbei02.pdf>