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OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE

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CONGRESSIONAL TESTIMONY ON SMALL BUSINESS CAPITAL FORMATION

I am testifying today as the Co-Chairman of the National Small Public Company Leadership Council. The Leadership Council, based in Washington, DC, seeks to educate and inform members of congress about the economic contributions of small emerging growth companies.

The Leadership Council is committed to assisting small business, both public and private, in capital formation issues. Our initial goal was to provide a forum for small-cap public companies seeking regulatory relief, we have since expanded our focus to address the overall concerns for all small business owners. The Leadership Council has represented the interests of small business to the securities regulators who govern our industry and the policy makers in Washington, DC. The Leadership Council now holds regularly scheduled meetings where small public company's, small business owners, venture capitalists and members of the investment banking community exchange ideas, voice opinions on pending legislation and become educated on matters affecting our industry. As our organization grows, we hope to enhance our contribution to regulatory and legislative matters.

INTRODUCTION

While the largest public company's, banks and brokerage firms have lobbied the Securities and Exchange Commission (SEC) to adopt new laws and regulations. The small business owners of this country have basically been ignored. The eighteen (18) year economic boom has over shadowed the concerns of small businesses, which were the biggest driver of new jobs in our country. Regulators and Politicians have either ignored the concerns of small business or in many cases not aware of the problems small businesses face. In the process, they are potentially threatening the longest economic expansion in our country's history. The Leadership Council urges that any new laws and regulations consider its impact on the small business marketplace. The Leadership Council believes that ignoring the issues that face small business could jeopardize our economy.

A SHORT HISTORY OF MARKET CHANGE

The evolution of our securities markets can be characterized as having three distinctive phases of its development; creation, regulation and deregulation.

The creation of our financial markets started with the Buttonwood Agreement in May 1792 (named for a tree at 68 Wall Street under which they traded) and ended with the crash of 1929. During this era we saw the creation of The New York Stock Exchange, The Stock Ticker, Gold Rush of 1849, Robber Barons and WWI.

The regulation phase of our financial markets started with the crash of 1929 and ended May 1, 1975 ("May Day") when the Securities and Exchange Commission (SEC) eliminated the fixed commissions brokers were charging for all securities transactions. During this era we saw the creation of the Securities and Exchange Commission (SEC), the adoption of the Securities Exchange Act of 1934 (Exchange Act), Investment Company Act of 1940 (Investment Advisors Act), National Association of Securities Dealers (NASD) and WWII.

The deregulation phase of our financial markets started with "May Day" 1975 and is ongoing.

Since 1975 we have seen the fall of Glass Steagall, The National Securities Markets Improvement Act (NSMIA) signed into law, the creation of the Internet, end of The Cold War, creation of the National Market System, creation of the P.C. and the crash of 1987.

As we enter into the next phase of our securities markets, globalization, many changes need to be made. First and foremost is the modernization of our securities laws. In 1998, the most significant initiative undertaken by the SEC since the 1933 "Securities Act" and the 1934 “Exchange Act” were signed into law. Dubbed “The Aircraft Carrier”, due to its enormous size, would modernize the securities markets and overhaul the 1933 and 1934 acts. Although, I doubt the “Aircraft Carrier” would be passed into law in its current state, certain segments can be implemented and some already have.

OVERVIEW OF SMALL BUSINESS

The dramatic expansion of our economy in the 1980’s and 1990’s was that entrepreneurship flourished, due mainly to large firms downsizing and reorganizing. Small business owners with some great new ideas became the leaders of our “New Economy”. Company’s like Home Depot, Intel, Microsoft, Oracle, Wal-Mart and Cisco Systems have created more economic wealth then anytime in our history. What people forget to remember is that all these company’s were small businesses with a good idea. All of these company’s struggled during their inception with: capital, laws, regulations, hiring qualified employees and employee benefits. They virtually clawed their way to the top. Remember this was the era of big business and still is. Our goal is to help small businesses lower these impediments and create an even greater economic boom.

Now is the time for small businesses to be heard. For the last 200 years congress has focused on big business. The laws and regulations passed over the last two century’s were result of the size, power, capital and lobbying that big business had on our economy.

The results of small business on the economy speak for themselves, according to the SBA office of Advocacy Findings:

- small business with fewer than 500 workers employ 53% of the private non farm work force
- contribute 47% of all sales in the country
- responsible for 51% of the private gross domestic product

- over the 1990-1995 period, small firms with fewer than 500 employees created 76% of net new jobs
- 60% of new firms begin at home
- number of business tax returns filed in the U.S. has increased 73% since 1982 to 24.8 million in 1998 - more than 99% were filed by firms defined as small under size standards set by the SBA
- about 21 million Americans - 17% of all U.S. non-agricultural workers - are engaged in some entrepreneurial activity
- micro-business with 1-4 employees generated 60.2% of the net new jobs over 1994-1998

Small business now controls the power and size of our economy and the SBA's numbers prove this. What they lack are capital and lobbying, both of which are being addressed today.

The Leadership Council believes greater access to the capital markets is needed to fund the growth engine of our economy, which is small business. I am proposing ten (10) initiatives to help both small public and private company's compete in our global economy. It is the job of congress to recognize the issues relevant to small business and when creating new laws and regulations to take into account the economic impact of these actions.

SMALL BUSINESS CAPITAL FORMATION

The life blood of any business is capital. It gives businesses the ability to grow and sustain economic or industry downturns. Although, the Government has created an efficient market mechanism to raise capital, it still needs tinkering from time to time. With the dramatic growth of small business in our country we need a more efficient way to raise needed capital. The current laws and regulations, which allow companies to raise capital, were created in the early 1930's and have been periodically amended. The problem with many of these laws is they were created with large company's in mind, they do not take into account the cost-benefit impact of a small business abiding by these securities laws.

The U.S. capital markets are one of the most efficient markets for raising capital, but they could be improved. Unlike our global competitors, the U.S. markets rely on an informed retail investing public. These investors are the lifeblood of our capital markets. These investors come in various stages of a company's capital raising requirements. It is the U.S. investor that funds the economic vitality of our great nation. The SEC segregates the U.S. investor into two classes, accredited and non-accredited. The standards set by the Securities and Exchange Commission (SEC) for accredited investor (high net worth) are; liquid assets of at least $1 million, or an annual income of $200,000 for individuals, $300,000 for couples. By this definition, there are some five million accredited investors in the United States. Of the 51 million Americans that own individual stocks (as opposed to owning shares in mutual funds) 46 million would be classified as non-accredited.

All company's at one time or another were classified as small businesses. All company's need capital to implement their business plans. How company's raise this capital and at what stage of their development, dictate the type of investor they can use and the cost of that capital.

In 1982 the government created Rule 504 "The Seed Capital Exemption" for small businesses. Its intent was to create a tool for small company's both public and private to raise equity without huge costs and minimum government regulation. As Rule 504 proliferated up thru the mid-1990's, fraud crept into this form of offering. In 1998 the SEC enforcement arm trying to eliminate a scheme known as "Pump and Dump" amended Rule 504 to eliminate this abuse.

When the SEC amended Rule 504 and the NASD amended its listing requirements, it quite possibly may have eliminated a whole generation of future S&P 500 components. By trying to eliminate the fraud of a few it threw the baby out with the bath water. The NASD de-listed over 3000 company's off the bulletin board, over 50% of its components.

Whether Rule 504 could be amended again might be a moot point. The SEC and the press have created such a negative stigma, relating Rule 504 to fraud, that it might never be used again. Instead, my proposal would be to create a new Rule 509 offering exemption. It incorporates all the positives in Rule 504, 505 and 506 exemptions with the modernization of our financial markets and actually increases investor protection issues.

Highlights of a new Rule 509 would include:

- link Rule 509 with the qualified small business stock exemption under tax code 1202 and 1045
- issuer must maintain a website with current news & financials
- can be offered thru advertising, internet and mail using a similar NASAA model investor exemption approach
- offered to both public & private companies
- maximum offering 12 months $10 million - minimum offering $2 million
- audited financials yearly (private)
  audited balance sheets quarterly (private)
  publicly traded company's on national exchange would comply with reporting guidelines
- must use a NASD member underwriter
- maximum underwriter compensation is 15%
- must escrow proceeds until minimum contingency is met

- minimum revenue, assets etc. to use the exemption
- used for company's below $50 million in assets
- term sheet used for all investors
- prospectus/memorandum delivery required
- electronic annual meetings
- road shows on line
- can use an unlimited number of accredited investors, up to 35 non-accredited with financial sophistication or pre-existing relationship or unlimited number of semi-accredited investor - net worth of $500,000 or annual income of $100,000 per natural entity or $150,000 married and can invest up to $25,000 with the issuer every 12 months but can not exceed 10% of their net worth per year.
- minimum hold of six (6) months before they can be registered
- if using a convertible debenture or preferred issue cannot use if there is not a floor on the convertible price and it can not exceed 20% or more dilution of the shares outstanding

  unless -
- any offering which dilutes the outstanding stock by more than 20% needs shareholder approval

The Leadership Council believes an efficient capital instrument can be created on existing laws or can be amended to give small businesses cost effective capital with the public adequately protected.

ILLEGAL SHORT SELLING

Investors whose “short” stocks are despised by many company’s because they profit from a company’s misfortune and plunging market capitalization. Shorting a stock means borrowing shares to sell, then “covering” the loan by buying the company’s stock on the open market.

Illegal short selling occurs in three categories.

First, where investors and broker-dealers heavily invested in a short position of an issuer, will disseminate false, negative information to drive the stock price lower, then covering their position. Short-sellers can use the news media or a more cost effective approach, the Internet.

Second, when short sellers ambitions concern a hostile takeover it will grossly exaggerate or falsely spread negative information to drive down the price of the target company. This allows the takeover company to accumulate cheap shares.

Third, when “toxic convertible” investors short shares to drive down the conversion price of their note. By driving the share price down before the conversion date occurs, the investor receives more shares of common stock than if the market had been allowed to trade freely. These investors are in effect hedging their position.

It is “naked” shorts that the SEC should focus on. A “naked” short is selling a stock short without ensuring that the stock can be borrowed or otherwise provided for by settlement date, also known as an affirmative determination. The NASD prohibits “naked” short sales. In order to short a stock, your broker-dealer needs to locate stock before they can loan it to you. If they can’t find any stock to loan, you can’t short it. It sounds good in theory, but when a company has enormous short interest, sometimes the amount of shorts outnumbers the shares on the publicly traded float. How can this be? The reason is “naked” short selling.

Someone is shorting the stock without first locating it. Market-makers and foreign institutions are usually the cause of this situation.

I have listed some possible solutions to these abuses:

- same "uptick" rules should apply to all stock exchanges (bulletin board, small cap) as a requirement to make a short sale
- broker-dealers should be required to meet the same coverage requirements for "naked" shorts as applied to investors and 100% haircut on such shorts should be enforced against violations
- a mechanism needs to be implemented to track short selling
- shorting of bulletin board, NASDAQ small cap and NMS stocks below certain price ranges should be prohibited
- shorting of all stock within ten (10) business days after effectiveness of an IPO should be prohibited
- the identity or organizations holding 5% or more of the outstanding shares or 10% of the public or float, of an issuer would be required to file a new 13S with the SEC. Those that have beneficial ownership must file a 13-D, why not make those holding substantial short positions report also.
- once a broker "locates" stock he can not use it again, ex., Banks must maintain certain reserve requirements, set thresholds for the broker-dealers

Generally, short sellers make an invaluable contribution to the market, by stabilizing the market in extreme over-bought and over-sold situations. It is when fraud is the short sellers main ambition, usually involving small cap securities, that damage our financial markets.

The SEC and NASD haven't taken the necessary steps to correct this situation. There are now cases where company's are contacting their shareholders to call their brokers and have their shares taken out of street name so the broker-dealer can's lend them to the short sellers. There are even cases of shareholders banding together to fend off the short sellers.

Having shareholder's band together and company's encouraging their shareholder's to request their stock certificates, can not be good for our capital markets. The abuses occur most of the time, in the small cap markets where small businesses go for their capital. If the public loses faith in these markets, the ability to raise much needed capital for small business will be jeopardized.

MINIMUM STOCK LISTING REQUIREMENTS

A company's stock price should have no bearing on listing requirements. When a company's stock price approaches or drops below minimum listing requirements it actually fosters fraud and unethical practices. By imposing an artificial guideline in a free market mechanism, it forces management of public company's to take swift dramatic steps to correct the situation. If a company's stock price is nearing or drops below its listing requirements it is usually because of market conditions, economic conditions, industry conditions, or failure of its business model, of which three of them are out of management's control.

A company's management has limited options to keep itself from being de-listed. It could create artificial demand by issuing press releases, hiring promoters or reverse split its stock. All of these efforts are usually offset or exceeded by the short-sellers.

Once a company is de-listed the ability to raise capital becomes virtually impossible. If a company is successful raising capital at this point, the costs of this capital are usually enormous. The reason is if a company is de-listed its volume tends to decrease because many institutions and market makers will participate in national exchange listed securities only.

The NASD, SEC and State Regulators have numerous laws and regulations already approved to deal with the SEC's main concern about low-priced securities (known as "Penny Stocks"). All the exchanges carry minimum listing requirements, of which stock price is only one component used for continuation. All exchanges have provisions for minimum revenue, earnings, assets, shareholders, market capitalization, etc., or combinations of these factors. These are the provisions management should focus on, not stock price.

Common stock market wisdom says, "Implement your business plan and the stock price will take care of itself".

DEATH SPIRAL CONVERTIBLES

"Toxic Convertibles" or another well known name "Death Spiral Convertibles" have exploded over the last five (5) years. In 1995, a total of thirty-six (36) "toxic convertibles" raised $274 million, according to private equity tracker direct placement.com. In 2000, 220 toxic convertibles were completed, accounting for $3.2 billion of the $18.3 overall (PIPE) industry. Private Investment in Public Equity (PIPE) deals have become a major source of capital for public company's. PIPE deals have a place in our market, but it is their offspring the "toxic convertible's" that need to be regulated. In simple terms, a "toxic convertible" is a private placement that enables the investors to convert their securities at a discount to the current market price, usually with no floor or as to how low the conversion can go.

It is the long-term common stock investor that gets burned by these PIPE deals. A study done by Pierre Hillion, showed an investor who buys the common stock of an issuer loses, on average, 34% of his investment one year after a "toxic convertible" is issued. The study done from 1995-1998, is remarkable because their sample coincides with one of the strongest bull markets in history. In 2000, their were 220 "toxic convertibles" done, only five (5) were at a higher price then before the deal.

It is obvious the common stock investor is getting burned by these convertibles. The State of Wisconsin Investment Board has threatened to sue any of its portfolio company's that get involved with (PIPE) transactions.

Possible Remedies:

- a floorless convertible investor cannot hedge its position, short its position
- require convertible holders to file a new 13S filing, if the conversion is greater than 5% of the outstanding shares or 10% of the float.
- eliminate completely
- require floors
- eliminate variable or rest provisions

Out of the top 10 funds that invest in (PIPE) transactions, the number one fund over the last 12 months returned a whopping +599.88% and the number 10 fund returned +185.72%.

If the SEC can't find a way to enforce these convertibles, my advise to investors, "Don't invest in the company, invest with the funds." A 599% return in a year isn't too shabby.

RULE 144 HOLDING PERIODS

The evolution of technology has expanded rapidly into our financial markets. Moore's Law (computer processing speeds will double every eighteen (18) months) has crept into the financial markets, but has negative impact on investors. Rule 144 relates to the period an investor must hold onto a security before it can be sold. Current laws require a minimum of one (1) year for non-affiliates of the company and two (2) years for affiliates. Roughly 40% of the S&P 500 is made up of technology company's. The problem is, technology changes so rapidly that holders of stock in these hi-tech issuers become absolete before they can sell them. By lowering the holding periods from one (1) year to six (6) months for non-affiliates and two (2) year to one (1) year for affiliates, we will give the investor ample opportunity to exit his investment. This will cause both positive and negative consequences.

On the positive side, the lock-in effect of all the private placements done to date will create increased government tax receipts at ordinary income tax rates not at capital gains tax rates. Although being taxed at higher rates might be viewed as a negative, it is better than losing your entire investment and using it for tax losses. Another benefit would be the trillions of dollars that could be used to re-invest in new ventures. Another benefit is the cost of capital for these issuers would be reduced dramatically because the investor could become liquid at a faster rate. The shorter the holding period, the lower the discount.

On the negative side, this greater liquidity could induce fraud and issuers would have a greater amount of free trading stock hitting the markets.

SMALL BUSINESS IRA (SBIRA)

According to the Employee Benefit Research Institute (EBRI), less than one-fourth of workers at businesses employing fewer than 100 workers participate in a retirement plan. According to the most recent data available from the US Department of Labor, 79% of full-time employees in medium and large size firms are covered by an employment-based retirement plan, compared with 46% in small firms.

According to the 2001 Small Employer Retirement Survey (SERS) sponsored by the (EBRI):

- Reasons cited by small employers for not offering a retirement plan-Employees prefer wages and/or other benefits (19 percent); revenue is too uncertain to commit to sponsoring a retirement plan (18 percent); a large portion of workers are seasonal, part time, or high turnover (15 percent); it costs too much to set up and administer (12 percent); required company contributions are too expensive (10 percent); the business is too new (6 percent); and too many government regulations (4 percent).

- Nonsponsors' lack of familiarity with different retirement plans-Nonsponsors may be unaware of all the plan options available to them as small businesses. Many report that they have "never heard" of the following plan types: simplified employee pensions (SEP) (52 percent); traditional pension or defined benefit plans (36 percent); savings incentive match plan for employees (SIMPLE) plans, which were created by Congress specifically for small employers (34 percent); deferred profit-sharing plans (23 percent); and 401(k) plans (2 percent).
- Motivators cited to sponsor a retirement plan-An increase in the business' profits (44 percent of nonsponsors); a plan with low administrative costs that required no employer contributions (35 percent); business tax credits for starting a plan (23 percent); a plan that could be tailored to the unique needs of their business (23 percent); a plan with reduced administrative requirements (18 percent); availability of easy-to-understand information (19 percent); allowing key executives to accumulate more in retirement plan (16 percent); demand from employees (15 percent); repeal of top-heavy rules (10 percent); a plan that could be set up and administered completely over the Internet (7 percent); and lengthening of vesting requirements (7 percent).

What is interesting about this study, The Government can address certain issues and modify or create new plans to deal with small business owners concerns.

Certain issues that small employers cite for not offering a plan, cannot be addressed by congress such as: employees prefer wages (19%), workers are seasonal/part-time (15%)

and the business is too new (6%). If you add these up (40%) of small business owners you will never get to sponsor a plan.

Committing to a retirement plan (18%), costs to administer (12%) required contributions (10%) and Government regulations (4%), this amounts to (44%) of small business owners concerns for not offering a plan. Congress could help implement changes to help with these issues.

Lack of familiarity with different retirement plan options can be accomplished with more education.

All of the motivators Congress can address.

Now that we know why small business owners do not offer a plan, what can we do?

<u>401(k)</u> is a perfect instrument for small business if the costs, administration and top heavy requirements were lowered or eliminated.

<u>SEP/SIMPLE/IRA</u> are perfect instruments for small business if the requirement for mandatory contributions and top heavy requirements were eliminated.

My proposal, The Small Business IRA, (SBIRA) takes the best benefits of 401(k)'s, SEP's, SIMPLE's and IRA's and combines them into a simple, cost effective instrument for small business owners.

(SBIRA) Highlights:

- no mandatory contributions, like the 401(k) but can offer voluntary matching contributions
- a simplified tax form, example form 5500
- eliminate top heavy restrictions
- offers up to $10,000 per year for all owners and employees
- ease of use, little education needed to administer the plan

I am sure congress can draft a retirement vehicle that small business can embrace.

<u>SMALL BUSINESS HEALTH INSURANCE PROGRAM</u> (SBHIP)

The Health Insurance Association of America (HIAA) has developed a package of proposals that are intended to address the growing number of Americans who lack health coverage. Employee benefits are a small business owners biggest expense. Lack of healthcare coverage for its employees, puts the employer as a major disadvantage in hiring from the labor pool roughly 70% of the small business owners do not offer healthcare benefits to their employees. Cost is really the only benefactor.

I support three parts of (HIAA) proposal:

- Small employer tax credit for health insurance premiums
  - 40% credit for employers with fewer than 10 employees
  - 25% credit for employers with 10-25 employees
  - 15% credit for employers with 26-50 employees
- Allow employee contributions for health insurance to be excluded from taxable income (even if not made through a section 125 cafeteria plan).
- Allow individuals to deduct the cost of health insurance premiums (including allowing the self-employed to fully deduct the cost of health insurance premiums immediately)

(HIAA) Estimates:

- About 71 million people would be eligible for the tax credit, either through their employer or the employer of their family head, 20 million of whom are currently uninsured. We estimate that as a result of this credit between 2.6 and 4.1 million uninsured will gain coverage as a result of the tax subsidy at a cost in revenue expenditures of between $23.8 and $29.3 billion annually.

- Exclusions from taxable income for employee contributions to employer coverage. About 750,000 and 1.2 million individuals would gain coverage as a result of this proposal, at an annual cost in revenue expenditures of between \$6.4 and \$7.4 billion.
- Deductibility of premiums for individual purchasers including the self-employed would cover between 1.5 and 3.5 million individuals could gain coverage through the individual market. Costs to the Federal government would be between \$7.8 and \$8.7 billion in lost income tax annually.

There are 42 million Americans that are uninsured. Although, the proposals I listed would only eliminate 4.8 - 8.8 million uninsured and cost \$38.0 - \$45.4 billion to the government, it would help small business owners become more competitive in the labor pool.

<u>QUALIFIED SMALL BUSINESS STOCK (QSBS)</u>
(Internal Revenue Code 1202 and 1045)

Small Business Capital Formation received a massive windfall when the Revenue Reconciliation Act of 1993 was passed. The act gives limited exclusion for non-corporate taxpayers for 50% of any gain from the sale of "Qualified Small Business Stock" held for more than five (5) years.

In 1993 the maximum federal income tax applicable to capital gains was 28%, so a 50% reduction lowered it to 14%. When congress passed the Taxpayer Relief Act of 1997 and lowered the Federal Tax Rate from 28% to 20% it did not include a reduction in qualified small business stock, so it currently stands at 14%.

My proposal is to first lower the five year rate down to 10%, where it should have gone after the Taxpayer Relief Act of 1997 was passed. Second, if the taxpayer continues to roll the gains into other qualified small business issuers at lower capital gains rates. I propose for every year after the initial five year holding period that the tax rate drops 1% per year for ten (10) years. After ten (10) more years in the program the taxpayers capital gains rate would be zero on any gains rolled over for fifteen (15) consecutive years. My rationale is simple risk versus reward. Every time the taxpayer rolls into another qualified small business issuer, the odds of success diminish rapidly. Venture capitalists are successful two (2) out of every ten (10) investments are. The better V.C.'s might average three (3) successes out ten (10). The taxpayer has only a 20% chance of success on his first investment based on professional V.C. numbers. Odds are the taxpayer will have even lower odds of success. Reason, a professional venture capitalist spends 300 hours per investment idea in due diligence. I doubt the average accredited investor is spending this much time per investment. The laws of diminishing returns are against the taxpayer, but for their risk we should reward them with lower capital gains rates.

Third, (QSBS) should apply to all company's not just certain industry's.

Fourth, get rid of C corporation only clause and open it up to sub-chapter S corporations, limited liability corporations and partnerships.

Fifth, eliminate AMT Tax provisions.

Sixth, increase roll-over period to 180 days from the current 60 days.

Seventh, eliminate the maximum gain provision completely.

Although, this is one of small businesses best capital formation tools to attract investor, nobody can use it in it's present form. According to the 2001 budget, only $40 million in tax expenditures were declared. Clear evidence, this is a tax break nobody can use.

CAPITAL GAINS TAX RELIEF

"To Spend or Save" that is the question. Under our current tax code, we reward the consumer who takes the money they earn and spends it. If they spend instead of save their wages they are rewarded with lower taxes. On average, the consumer may pay 5% sales tax to buy a new T.V. but if they invests it into General Electric, the manufacturer of the T.V., and sells it for a capital gain, the investor gets taxed at 20%. If the investor sells it under one (1) year they are taxed at their ordinary tax rate, which could be as high as 39.6%. To spend (5% taxation) or save (39.6% taxation) no wonder the household savings rate (percent of disposable income) for our country is lower than most developed nations, averaging below 4% for the last decade.

No one has yet to convince me that a capital gains tax benefits our economy. In fact, I have never read any article, seen any research or heard anyone say capital gains tax benefits our economy. Why? Because it doesn't. If you do believe that capital gains tax benefits the economy then what you are saying is that the 20% tax the investor is getting penalized for being right would be better spent by the U.S. Government, not the investor.

Economic growth depends on quantities of capital and labor and the productivity of these factors. Economic growth cannot occur unless productivity improves, quantities of capital and labor increases or both. Investment capital is critical for the economy. High capital gains tax rates lower the return on investment, thus increasing the cost of capital and depressing overall investment in the economy. Consequentially, a capital gains tax reduction would lower the cost of capital and stimulate investment. Increasing capital formation would be felt throughout the economy in the form of increased jobs, better standards of living and higher wages.

Since the end of The Cold War, which lasted some 45 years, the U.S. has been reaping the rewards of victory. New global markets in which to sell our goods and services.

It is not a coincidence that our ten (10) year bull market traces back to the fall of the Berlin Wall. America's new enemy is global competitiveness for its goods and services. The U.S. Capital gains rate exceeds that of any industrialized nation except the U.K. and Australia, however these nations index for inflation. Now the U.S. must compete globally for capital. Higher capital gains tax rates puts U.S. industry at a competitive disadvantage for capital. Almost every industrialized nation experiences higher savings, investment and productivity growth rates compared with the United States. We need to eliminate or reduce our capital gains tax rate to stay competitive in the new global economy.

I think Federal Reserve Chairman Alan Greenspan said it best in his testimony before the U.S. Senate Banking Committee on February 25, 1997: "The point I made at the budget committee was that if the capital gains tax was eliminated, that we would presumably over time see increased economic growth which would raise revenues for the personal and corporate taxes as well as the other taxes we have. The critical issue about the capital gains tax is not its revenue-raising capacity. I think it is a very poor tax for that purpose. Indeed its major impact is to impede entrepreneurial activity and capital formation. While all taxes impede economic growth to one extent or another, the capital gains tax is at the far end of the scale. I argue that the appropriate capital gains tax rate was zero.

How do we help small business capital formation? Eliminate or reduce the capital gains tax. Here are some reform initiatives:

- Eliminate the capital gains tax altogether. Many of our global competitors have no capital gains tax.
- Index for inflation, if we can't lower the capital gains tax rate, at least we could index it for inflation. We index every other government program to inflation.

- Eliminate capital gains taxes for those securities that have a market capitalization below $250 million dollars. A bill introduced in the House of Representative Jim Greenwood would accomplish much of this.
- Reduce capital gains tax - any reduction would benefit small business. Two capital gain tax reduction proposals have already been submitted, S.66, a broad-based capital gains proposal introduced by Senators Hatch, Lieberman, Grassley and Breaux, which provides for a 50% exclusion for individuals and a 25% corporate capital gains tax rate and H.R. 14, introduced by Representatives Drier, Hall, McCarthy, English and Moran which provide for a 14% marginal rate for individuals and 28% rate for corporations among other provisions would help small business capital formation.
- Rollovers - Have a program similar to the housing rollover where if you hold the asset a predetermined number of years, say 5 years, you can continue to rollover the capital into another investment without incurring capital gains taxes until such time you decide to cash out, as long as you reinvest the assets within 120 days.
- $500,000 lifetime capital gains credit - Have a program similar to the Housing Program, where you get up to $500,000 in capital gains excluded from tax during the lifetime of an individual. It wouldn't cover property, collectibles etc., but it would include stocks, bonds, mutual funds etc.
- Holding period incentives - A program where the longer you hold an asset the lower the capital gains.

Example:	Holding Period	Capital Gains Tax
	0 - 1 year	ordinary income tax rate
	1 - 2 years	20% capital gains tax

2 - 3 years	15%	"	"	"
3 - 4 years	10%	"	"	"
4 - 5 years	5%	"	"	"
5 + years	0%	"	"	"

These are only a few ways to reduce the tax burden on the money we have already been taxed on.

GUARANTEED COLLEGE EDUCATION PROGRAM (GCEP)

To increase productivity and stimulate economic activity, businesses need a qualified educated work force. Due mainly to the lack of capital, small business is at a severe disadvantage when it needs to hire employees. Large company's have the necessary capital and employee benefits to hire the best educated from the labor pool. Those employees not taken by the large employers are generally what small businesses have to work with. What is disturbing is that large company's cannot even find enough qualified employees to hire. A case in point, the uproar in HB-1 visas. The visas allow foreign workers to fill job vacancies in our country. The number of visas allotted for 2000 was 115,000 and we reached this number in six (6) months. The high-tech industry is scrambling to get congress to raise the number of visas north of 200,000 annually to fill their employment needs. If Silicon Valley gets its way, that is 200,000 jobs lost by U.S. citizens a year.

The objective of the guaranteed college education program (GCEP) is to provide college education to every citizen born in the U.S. starting January 1, 2002. The national interests of the USA both economically and socially are served by a better educated citizenry and workforce. Post secondary educational needs will increase growth in importance as dramatic technological changes occur. The U.S. workforce will be at a competitive disadvantage in the world without continuing education and enhanced sophistication in the workplace. Additionally, social relations in the U.S. will suffer as the disparity on wealth becomes increasingly proportional to those with advanced knowledge that is not available to all Americans.

The theory behind GCEP is post secondary education must be made possible for every American. GCEP will provide targeted money to students who are willing and able to continue their education. The program will enable children to pay for their own educational costs respective of family or social circumstances. If a child wants to attend college, that child will have means to attend.

GCEP starts when a child is born in the U.S. and receives a social security number. The Federal Government will then purchase an average of $10,000 worth of U.S. Government Treasury Strips in the child's name and social security number. The funds will be put into an escrow account and will mature around the child's 18th birthday. Upon the child's receipt of a High School Diploma or equivalent (GED) and accepted into an accredited institution, the child will receive a swipe card from the Social Security Administration to be used for tuition, books, fees and other pertinent educational costs directly from their account. The child will have until their 35th birthday to use the entire amount of their funds for educational pursuits or the remaining money will revert to the Social Security Trust Fund or pay down the National Debt. The $10,000 initial deposit will mature to roughly $30,000. According to preliminary research regarding cost of state colleges in the year 2020, $30,000 is projected to provide four (4) years of state college education.

Intended Outcomes:

- a large influx of students into colleges
- post-secondary education would become a growth industry

- increase in High School diplomas with each child knowing that money will be available to go to college
- a possible way to break some cycles of poverty through educational advancement
- could use GCEP money for advanced degrees; such as masters degree, a different undergraduate, technical degree or a doctoral program
- consolidation of multiple post secondary education programs thus saving overall administrative costs through economies of scale - example: Pell grants, Perkins loans, etc.
- starting in the year 2020, all higher educational programs could be eliminated
- used in conjunction with existing scholarship programs such as Hope. If a child loses their scholarship could remain in school using GCEP.

Funding:

- Initial outlay of $40 billion a year. 4.0 million children born in the U.S. every year multiplied by an average of $10,000.
- As of 1996, 81.5% of dependent 18-24 year olds had graduated High School and 58.9% had at least some college experience, according to higher education analysts at The University of Iowa. Using 1996 data, $40 billion x 81.5% x 58.9% = $19.2 billion actual cost of program in 1996 dollars assuming they attend all four years of college.

$ 9.1	Pell Grants est. 2001
49.0	Student Loans est. 2001
+ 3.4	Other Programs est. 2001
$61.5	Total Federal Program est. 2001
- 19.2	GCEP Program
$42.3	Billion savings to government per year starting in 2020

- could take $500 of the child tax credit roughly $20 billion/year to pay for program
- defaults on student loans are running at $25 billion/year, which is costing the taxpayer

There are numerous open issues such as: The Social Security Administration's infrastructure, re-engineering and support able to administer the GCEP, whether the government can even do this, whether the funding should be wholly financed, jointly financed through a partnership with private industry or as a sponsored private corporation.

Using 1991 data as an example of wage differences; college graduates earned $23.42/hr., some college $15.46/hr., High School graduates $13.28/hr. and High School drop-outs $9.79/hr., it is apparent that even a little additional education results in much higher standard of living, increased federal tax receipts and a better labor pool

In conclusion, changing a child's mindset at a very early age (I <u>can</u> go to college) might help break some generations of family socio-economic circles prevalent in the lower income groups. The elimination of dozens of federal programs and cost savings to the government. Basically what the government is doing is expanding K-12 to K-16. I think our nation's greatest resource, human capital, is worth $40 billion a year.

<u>IN CONCLUSION</u>

The Leadership Council recommends establishing a small business task force to evaluate proposed, existing and pending laws and regulations that affect small business. The Leadership Council is willing to take an active role in establishing this task force and will work with regulators, market practitioners, issuers and investors to make recommendations that address the interests of the small business community.