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Small Business: It Makes Free Enterprise Work

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SMALL BUSINESS

It Makes Free Enterprise Work

Testimony before the House Committee
on Small Business holding hearings

on

**House Resolution 1306
Small Business Impact Act**

and

**House Resolution 1745
Small Business
Regulatory Relief Act**

by

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**SMALL BUSINESS
It Makes Free Enterprise Work**

Testimony of D. P. Diffine, Ph.D.
Before the
House Committee on Small Business
Holding Hearings on

**HOUSE RESOLUTION 1306,
SMALL BUSINESS IMPACT ACT**

To require the preparation of small business impact statements in connection with federal agency rules.

and

**HOUSE RESOLUTION 1745,
SMALL BUSINESS REGULATORY RELIEF ACT**

To amend the Small Business Act to provide regulatory flexibility for small business in certain instances so that the effect of regulation matches the size of business regulated.

Mr. Chairman and Members of the Subcommittee:

I am appearing today on behalf of small businesses and an economic system in which a person should be "free" to be anything he wants if he has the "enterprise" to do it. Although I'm more of an academic entrepreneur, I speak to you to represent real enterprisers--some of whom I've served in the past as a Small Business Institute faculty adviser.

As sincerely as I know how, I wish to plead the case of the small business person who, in all honesty, doesn't know if he's being a crook or a martyr when it comes to complying with federal regulations and the attendant paperwork.

I would like to tell you about a county executive in the Midwest who was asked by a federal installation if the latter's employees could park at the nearby and usually deserted county airport. Our hero requested an environmental impact statement, in triplicate: "*How many cars; during what hours; the average EPA rating for vehicles involved; and an affirmative action report on all personnel involved--preferably back at least three generations.*" Now that's news. Man bites dog!

The fundamental soundness of our economy is each business' responsibility to operate under its own steam--to know that it can survive and profit only if it produces something consumers want and are willing to pay for. There are risks involved. Our economy is filled with skeletons, large and small, of those who tried and failed to meet this exacting standard.

It must be recognized that Federal regulatory policies often work a hardship on the small firm that the large firm is able to escape. Large firms have at their command a myriad of resources: lawyers, accountants, and a bureaucratic organization that enable them to absorb the impact--and indeed to deflect it--of Federal regulations. The small firms possess none of these advantages.

I would remind you, as have others, that all regulatory policy should have categories. And without retreat on regulatory objectives, there should always be consideration of cost and reporting requirements for the small firm. By treating large and small alike, one treats them differently.

Once created, regulatory agencies tend to be self-perpetuating--promulgating more regulations, seeking rulings or test cases against smaller firms before seeking out the big ones, and generally trying always to improve their prestige and "*batting averages*" before Congress in order to secure larger appropriations for the following years.

According to the National Federation for Independent Business, the impact of regulations is disproportionate in three ways: (1) discovering regulation, (2) understanding regulation, and (3) paying for regulation. This disproportionate impact means that in order to remain competitive with large firms, the small business must cut back in some manner.

The small business can reduce earnings (implying less "*take-home*" or reduced business investment); it can reduce overhead in some cases (such as cutting employment); or, it can go out of business. As the NFIB has pointed out, if the two former are undertaken with any frequency or if one action is particularly severe, the latter is inevitable. Small firms simply cannot absorb a continually deteriorating competitive position.

Small Business--The Darling of American Capitalism

I am concerned because it is the small businesses that provide most of the jobs in this country. There are more than 13 million smaller enterprises in the United States. Individual enterprises may be small, but together they form one of the main components of our national economy. Small business currently makes up 95 percent of all commercial and industrial entities in the United States, and employs 60 percent of the labor force.

We count on these same small businesses for 48 percent of our total business output, 43 percent of the Gross Domestic Product, and more than half of our important industrial inventions and innovations. And strong flow of private investment back into smaller companies must be regained if we are to take advantage of their highly labor-intensive potential.

"...What most astonished me in the United States was not so much the grandeur of some undertakings as the innumerable multitude of small ones."

Alexis de Tocqueville
Democracy in America (1840)

A company may be forced to reduce its size, forced out of business, or be forced to lower the benefits it offers for many reasons: (1) if it cannot or will not invest in new, modern tools and/or adopt modern management methods; (2) if its goods or services are not of competitive quality; (3) if its workers refuse to use modern, labor-saving devices; and/or (4) it cannot economically comply with increasingly restrictive federal regulations.

It is still common to find new developments coming from small businesses instead of from the research labs of large corporations. Small businesses are not tied to existing technology. They are more prone to experiment, to innovate, and most important of all, to take risks.

Small business is what really makes our free enterprise system work, by keeping it lean, tough and competitive. Small business serves as an effective counterweight to the power of the large corporations, and helps to keep our system democratic. The question is, how long will small business be able to perform this role? More precisely, how long will government allow it to perform this role?

I agree with the United States Industrial Council:

Small business is slowly but inexorably being squeezed out of our economic system, and all the pressures but one--the upsurge in product liability lawsuits--are being applied by government. Heavy government borrowing from private banks has made it difficult for fledgling enterprises to obtain loans. High taxes and inflation are eating into other sources of investment capital. Increases in the minimum wage are putting labor out of reach for many employers. But the biggest single problem that small businesses face is the government regulations.

Since the mid-1960s, federal regulation of business has tripled. For the large corporation, this added burden is an expensive nuisance, but for the small business, it is a life-or-death struggle. The owner-operator of a small firm cannot possibly keep up with all the standards and rulings that are churned out by the bureaucrats in Washington, and he often cannot afford the legal advice and extra clerical help he needs to cope with them.

In the same way, he often lacks sufficient funds to redesign his product, change his method of operation, or otherwise bringing his business into line with federal requirements. Consequently, he has no choice but to sell out to a larger company or to close his doors. It is no accident that during the same period in which federal regulations doubled, the number of business bankruptcies also doubled--and most of the casualties were small businesses.

Federal Bureaucracy-- The Fourth Branch of Government

Examples abound of the government's intrusion into the private sector. A small 5,000-watt radio station in New Hampshire spent \$26.23 to mail its bulky application for license renewal to the Federal Communications Commission. One milk plant, licensed by 250 local governments, three states and 20 other agencies, reported that it was inspected 47 times in one month.

The philosophy of the super-regulator is a curious one. On the one hand, he's usually convinced that business is bad, and that big business is very bad. But on the other hand he's also frequently convinced that people in general are not very bright.

Because of their task orientation, regulatory employees are likely to have only a limited knowledge of the industries they regulate. In fact, it frequently seems that they pay little attention to the effects of their actions on the basic purposes of business and industry--to provide goods and services for the public.

Presently, more than 80 regulatory agencies and commissions and more than 100,000 government workers interpret and implement regulatory laws passed by Congress. Salaries paid employees of federal regulatory agencies total \$5 billion a year--and are rising steadily.

Few would disagree with the announced goals of these agencies--clean air, safe working conditions, pure food and drugs, clean water, equal opportunity for all in the job market. There is a growing body of evidence, however, that the regulatory agencies are frequently not achieving their goals and that the costs of pursuing their objectives often exceed benefits to society.

There are those who argue that business is a special interest that stands apart from society as a whole--that "*The People*" are not affected by regulations. In reality, every person who works for a business, every person who buys products and services, as well as those who invest in businesses, are affected by the excessive and often ill-conceived policies of the regulatory agencies. A review of the impact of some of these policies underscores the need for a serious reappraisal.

The Bureaucracy--Our State Religion?

As Murray L. Weidenbaum, director of the Center for the Study of American Business at Washington University, has concluded, "*The public needs to grasp the notion that government regulation is a potent and expensive medicine. It needs to be taken very carefully, in limited doses and with full regard for all the adverse side effects--inflation, unemployment, loss of productivity, delay in getting new products, and loss of capital formation.*"

Inventiveness lies at the heart of America's high standard of living. With 5 percent of the world's people and 7 percent of the world's land, we produce more than 25 percent of the world's goods and services. The increasing intrusion of regulatory agencies into every aspect of our economy is tending not only to waste valuable resources and decrease productivity but also to stifle America's inventiveness and dynamism.

Yes, Congress should periodically review the need, soundness and fairness of regulatory statutes and evaluate the rules and regulations formulated by the regulatory agencies. Probably the most urgent need for change in regulatory processes is in the area of cost-benefit analysis. It hardly seems improper to suggest that benefits of regulations should be weighed against costs before they are applied.

For instance, when farmers complained about the lengthy applications and \$10 check required by the Environmental Protection Agency for a permit to discharge waste water, the Commission undertook to determine the cost effectiveness of its action. They discovered it was costing the agency \$15.09 to process each \$10 check and \$270.10 to process each application.

According to James J. Kilpatrick, the cost of government regulation ordinarily is computed in two ways--what it costs the government to enforce its rules, and what it costs the private sector to comply with them. A third price is paid, says Murray Weidenbaum. This is the unreckonable cost of what we don't receive.

Anyone who believes that regulatory costs are something that are ordained at enactment ought to thumb through the Federal Register. There is a small telephone directory's worth of standards and

procedures spelled out in the Federal Register every day. It is important to remember that most of those standards and regulations impose some kind of cost on somebody.

Federal regulations issued daily throughout the year, except December 25, are 200 pages thick--and it's the law of the land. Business people have to hire lawyers at \$200 an hour to read it daily to see if it applies to them.

Although free enterprise provides us with a "full service" economy, we unfortunately have a state religion in this country. It's Federal Bureaucracy--the highest power to which, in the minds of most, we can appeal. Government's role has shifted from that of "protector" to that of "provider--from referee to quarterback."

What to Do--Now

To treat large and small business as the same is both irrational and unfair. As a first step towards reversing the tide against small business, I agree with the NSBA in recommending institution of "two-tier" systems of regulations and laws in the areas of antitrust, patent and regulatory policy.

Let us not forget why the small business community is the darling of American capitalism: The ability of small business to give personal service and provide quality goods and services; to provide an alternative to large corporations for both consumers and employees; to police the marketplace through competition between many companies; and, not least, to provide an outlet for the independent and adventurous spirit that is the hallmark of the small business entrepreneur.

I wish to point out that big business is, to a large degree, dependent on small business--small business is the supplier of the products which larger companies assemble into finished products. Sound development of the small business community is necessary for economic growth of the economy overall.

Therefore, all government agencies should begin or increase their efforts to ensure that their regulations and the application thereof do not have a disproportionate economic impact on small business. All government agencies should make a concerted

effort to reduce the record-keeping paperwork burden placed on small business. Particular attention should be focused on simplification, standardization and nonduplication of existing regulations and requirements.

Agencies should have to identify alternatives for the proposed regulation, and choose the least costly. The agency would have to justify choosing a more expensive alternative. A "sunset" provision should require that once every 10 years an agency must review regulations having an impact on the economy of \$100 million or more.

The American Republic and American business are Siamese Twins; they came out of the same womb at the same time; they are born in the same principles, and when American business dies, the American Republic will die, and when the American Republic dies, American business will die.

—Josiah Bailey

Twice a year each agency should have to publish an agenda of major regulations expected to be acted upon, and projected dates for action. An agency contact, telephone number and address should be listed for each regulation. These agendas should enable you to get the jump on new regulations before they are proposed.

The economic impact statements should be done by the promulgating agency itself. Objectivity could be greatly enhanced by direct small-business participation. And the agency review should conform to a standard method approved by the Congress. The Federal Register should be indexed for small business interests. In it should be increased inclusion of small business representation on regulatory and advisory commissions.

I agree with the Small Business Legislative Council that, as part of its oversight function, Congress must determine whether agencies it has created are issuing rules and regulations contrary to law, inconsistent with legislative intent, and going beyond the statute it is supposed to implement. When an agency does commit abuse, the damage to small business subject to such rule or regulation may

be irrevocable. Therefore, the review period of 60 days or longer is essential.

What else, then, can be done to help small business survive in our increasingly regulated economy? Create special exemptions from regulation for small business, particularly in the area of time-consuming and often irrelevant paperwork. Require that federal agencies investigate and report on the likely impact of new regulations on small business before such regulations are promulgated. Reimburse small companies for legal expenses incurred while challenging government regulations in court, if such a challenge results in a verdict against the government.

Recapture Your Mandate

The self-perpetuating regulation industry must be confronted at the sources of its mandate, so that you might transform the burden of overregulation into a manageable and even positive force. Yes, all laws spelling out regulation, and all major regulatory decisions, should be required to first include an economic impact statement proving that their benefits outweigh their cost.

But let's go further. Officials at decision-making levels in regulatory agencies should be required to have demonstrable competence to regulate an industry, based on substantial knowledge of the industry itself. Unlike ineptitude, conflicts of interest can be curbed, if need be, by vigorously enforced criminal penalties. Regulatory bodies should all the more be subject to real periodic Congressional review, to limit their life spans.

I would like to have made some modest and uncomplicated proposals. They would amount to little more than requiring the regulatory industry to operate by the same rules as the industries they regulate. Any corporation that ignores either economies or competence for long simply ceases to exist--and that is precisely the right fate for a good part of the regulatory system.

I would conclude with a word of caution regarding regulatory reform. Baron Von Frankenstein was a man who meant well. Death distressed him, and with the best intentions he sought to "*re-create life.*" Using transplants, he made a dead man alive--produced an unnatural creature who was at first

benign but rapidly deteriorated into a fiendish monster.

Let's be super-careful to do only those things that continue to give decent life to the system that supports us--our economic horn-of-plenty that we call free enterprise.

EPILOGUE

I have always believed that owners of small businesses are personified in the message of the *Entrepreneur's Credo*, originally penned by Dean Alfange:

I do not choose to be a common man. It is my right to be uncommon...if I can. I seek opportunity...not security. I do not wish to be a kept citizen, humbled and dulled by having the state look after me. I want to take the calculated risk; to dream and to build, to fail and to succeed.

I refuse to barter incentive for a dole; I prefer the challenges of life to the guaranteed existence; the thrill of fulfillment to the stale calm of Utopia. I will not trade freedom for beneficence nor my dignity for a handout. I will never cower before any master nor bend to any threat.

It is my heritage to stand erect, proud and unafraid; to think and act for myself, to enjoy the benefit of my creations and to face the world boldly and say: This, with God's help, I have done. All this is what it means to be an Entrepreneur.

The **ENTREPRENEUR** is a quarterly journal and newsletter addressing contemporary economic issues from a moral perspective. One may not agree with every word printed in the **ENTREPRENEUR** series, nor should he feel needs to do so. It is hoped that the reader will think about the points laid out in the publication, and then decide for himself.

ABOUT THE AUTHOR

Dr. Don Diffine is currently Professor of Economics at Harding University in Searcy, Arkansas, and Director of the Belden Center for Private Enterprise Education. The Senior Research Associate of Harding's American Studies Institute, Dr. Diffine is also the Director of Economics Teams that have won First Place in national Students in Free Enterprise competitions on six occasions.

Listed in the Heritage Foundation's **Guide to Public Policy Experts**, Dr. Diffine is the author of a 200-page **Facts Book for Business and Industry** and is published frequently in the **Journal of Private Enterprise**. He currently has over 90 articles and monographs in print.

Dr. Diffine is the recipient of the Freedoms Foundation George Washington Honor Medal for his article "*All American Economics--Made in the U.S.A.*" He is the editor of the **ENTREPRENEUR**, a journal that has received five Freedoms Foundation awards in the category of Non-profit Publications. In 1990, the National Flag Foundation presented its "*New Constellation Award*" to Dr. Diffine for his booklet, "**TO THE FLAG--Our Banner of Liberty.**"

The recipient of the \$7,500 Freedoms Foundation Principle Award for Excellence in Private Enterprise Education, Dr. Diffine has received nine other Freedoms Foundation awards in the categories of Economic Education, Public Affairs-Advertising, Public Address, and Published Works. He is also the faculty winner of a \$1,000 First Place prize in a National Essay contest judged by Nobel Economist Milton Friedman.

In 1988, the First Annual Distinguished Scholar Award was presented to Dr. Diffine by the Association of Private Enterprise Education. He is listed in **Personalities of the South and Outstanding Educators of America**. The Wal-Mart Foundation has designated him as a Samuel Moore Walton Free Enterprise Fellow.

Dr. Diffine has provided Congressional testimony on business problems, economic impact statements, and inflation-recession dilemmas. A member of the International Platform Association and also an economic humorist, he is a frequent speaker for conventions, management clubs, stockholders' meetings, trade associations, and chambers of commerce.