Government Policy and Small Business Financing

Murray L. Weidenbaum
Washington University in St Louis

Small businesses are hurt by government policy and regulation.

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Murray Weidenbaum

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Contact: Robert Batterson
Communications Director
(314) 935-5676
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by Murray Weidenbaum

Federal government policy for financing small business reminds me of the motorist who puts one foot on the gas pedal and, at the same time, puts the other foot on the brake. I'll explain the situation briefly and then show a way out of this dilemma.

Background

First of all, the sad fact is that new and small businesses are the marginal borrowers in the U.S. economy. They are always hurting for financing. In contrast, General Electric gets the funds it needs; sometimes it has to pay more. But especially during times of tight credit, Specific Electric gets rationed out.

Unfortunately, current government policy makes this situation more difficult for small business. For example, Treasury financing of huge budget deficits drains away a large portion of the funds in capital markets, making even tougher the competition for the remaining funds. High tax rates reduce the amount of retained earnings that can be reinvested, reinforcing the dependence on borrowed money. High capital gains taxes discourage potential investors in risky new and small companies. In addition, a wide array of regulation and mandates make it less likely that the small enterprise will make a go of it in the first place.

There literally are economies of scale in complying with government directives. Giant General Motors pretty much fills out the same forms and meets the same requirements as small Specific Motors. The result is that the cost of regulation is a much higher percent of sales for a small company than for its larger competitors.

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Murray Weidenbaum is Director of the Center for the Study of American Business at Washington University in St. Louis. This text is from his testimony to the U.S. Senate Committee on Small Business on April 12, 1995 in St. Louis. The views expressed are his own.
While regulatory flexibility was supposed to provide small business relief in this area, little relief has actually taken place. In some instances, small firms are exempted from reporting requirements, but these are the exception and not the rule. Ironically, even this relief can work against small firms, placing a "glass ceiling" over their employment growth in order to avoid the high regulatory costs that kick in with the fiftieth employee.

There is good reason for focusing on taxation and regulation. The recently released survey by the National Federation of Independent Business shows that small companies believe that, by far, taxes and regulation are the two most important problems facing them.

**Changes in Public Policy**

It is not surprising, in light of this situation, that the federal government is continually being urged to do something special for small business. That is the basic justification for the expenditure and credit programs of the Small Business Administration. Frankly, there is a basic problem with pushing that approach too far. Specifically, less than 1 percent of the millions of small companies ever receive an SBA loan. The other 99 percent pay the taxes to support the program. Moreover, given the deficit problem, every dollar for a higher SBA budget means another dollar not available in private credit markets.

What should be done? The federal government should take its big foot off the brake. It needs to reduce the deficit, reform the tax system, and streamline government regulation. Progress on these three fronts will do far more to ease the financing burden on small business than any special purpose legislation aimed to help small companies.

I'd like to offer a few comments on each of these points. As an old budget cutter, I remember Harry Truman saying that he never saw a budget that could not be cut. In that spirit, no federal program should be "off the table." Congress should look for soft spots in every department and agency — with no exception.
As for tax policy, we need genuine tax reform. Senators Pete Domenici and Sam Nunn have been developing a savings-exempt income tax and a companion business cash flow tax. Their proposal eliminates 80 percent of the provisions of the income tax law and relieves the tax burden on saving and investment.

As for regulatory reform, the requirement for benefit/cost analysis now being considered by the Senate is exactly the medicine this doctor ordered. Rules that generate more cost than benefit do not make sense.

These three sets of actions are needed to create the economic conditions whereby small companies can generate and attract the capital that they so badly need.

My final point is the standard advice that I give to congressional committees, "Don't just stand there, undo something."