BARRIERS TO ENTREPRENEURSHIP:
How Government Undermines Economic Opportunity

By:
Naomi Lopez

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Executive Summary

Among lawmakers today there is no shortage of self-congratulation for a robust economy. Yet many of these same lawmakers are simultaneously promoting an expansion of government policies that hinder economic growth and economic opportunity. The unchecked proliferation of federal, state, and local tax and regulatory requirements is impeding new business formation and business expansion across the nation. Even the well-intentioned government-sponsored programs that aim to spur business formation and economic development are destroying economic opportunity for our nation’s families.

Nowhere is the impact of these counter-productive government policies more evident and far-reaching than in the area of small business formation and expansion. Small businesses, which are responsible for the vast majority of new jobs in our nation’s economy, are the first casualties of these counter-productive government policies. The result is that job creation, economic mobility, and economic expansion are stifled.

There is broad consensus among labor analysts that the vast majority of job creation occurs in small business. Even if one attributes other factors (such as demographics, technology, and consumers’ spending patterns) as the most important determinants in job creation, there is no doubt that almost all new job creation occurs in firms with fewer than 100 employees. Removing obstacles and reducing the regulatory and tax burdens on small business could have a substantial, positive impact on the ability of small business to facilitate job creation.

In the next century, America’s economic growth will heavily rely on the growth of new, smaller, technology-based firms that retain an innovative advantage over larger firms. Recent immigrants and low-skilled workers frequently begin employment in small firms or home-based businesses where they gain valuable experience that provides upward mobility and, in the case of immigrants, assists in the assimilation process.

It is easy to overlook the detrimental effects of government regulation and taxation on our nation’s entrepreneur community, especially during this period of sustained economic growth. Yet, mounting evidence suggests that small firms and entrepreneurs are critical for continued economic prosperity.

While government spending, regulations, and taxes may not create an easily observable detriment to small business, especially in times of economic expansion, there are opportunity costs associated with these policies. Policymakers should realize that there is always a need for positive policy change and that money directed to taxation, for example, is not available for private investment which is critical to business formation and job creation.

This strong economy offers an ideal opportunity for free-market advocates and small business proponents to re-examine government policy and offer alternatives for reform. Unleashing our nation’s entrepreneurial potential will have not only positive, long-term consequences on the economy, it will likely extend the current recovery and diminish the severity of any future economic downturns.
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By Naomi Lopez

America’s entrepreneurial tradition has provided the nation with a strong economic base, and it has been, for many, central to achieving the American dream. Today, however, the unchecked proliferation of federal, state, and local taxes and regulatory requirements is impeding new business formation and business expansion across the nation.

Nowhere is the impact of these counter-productive government policies more evident and far-reaching than in the area of small business formation and expansion. Small businesses, which are responsible for the vast majority of new jobs in our nation’s economy, are the first casualties of these counter-productive government policies. The result is that job creation, economic mobility, and economic expansion are stifled. Even the well-intentioned government-sponsored programs that aim to spur business formation and economic development are destroying economic opportunity for our nation’s families.

The 1990’s were ushered in with the politicians’ promise and taxpayers’ hope that the era of big government was over. Today, as we near the end of the decade, it is clear that big government has not only survived; it has, in many ways, prospered. To reverse this trend, free-market advocates and small business proponents must expose and reform these detrimental government policies and offer reform options that will unleash our nation’s entrepreneurial potential.

Most people, at some time in their working life, entertain the notion of running their own business. The idea of being one’s own boss and controlling one’s own destiny is appealing. Of course, to become an entrepreneur, one cannot have aversions to risk or hard work. But, in addition to the normal risks associated with business start-up, today’s would-be entrepreneur must also be prepared to endure the many government-imposed barriers such as excessive taxation and regulation.

Most Americans do not realize just how discouraging, threatening, and intrusive “Big Government” is until they run their own business. Linda Fisher of Westminster, Maryland found out when she faced severe financial penalty and possible prosecution for lacking the proper license and inspections to sell her $1.25 muffins out of her red Radio Flyer wagon.

This example documents what many entrepreneurs already know to be true — federal, state and local taxes and government rules are creating unnecessary obstacles to small business creation and expansion.

While many entrepreneurs eventually fail, others create permanent additions to the labor force and provide consumers with needed and desired products and services. According to labor economist Davis Birch, three out every four new jobs are created in 5 percent of small business expansions and almost nine out of ten occur in ten percent.

Entrepreneurship will be particularly important in the next century. America’s growth will heavily rely on the growth of new technology-based firms where smaller firms retain an innovative advantage over larger firms. Low-skilled workers and recent immigrants frequently begin employment in small firms where they gain valuable experience that provides upward mobility and, in the case of immigrants, assists in the assimilation process.
Snapshot

The vast majority of U.S. firms are “small” businesses — employing fewer than twenty. [See Figure 1.] These small firms account a significant portion of American job growth. [See Figure 2.] Of all firms with paid employees, small firms are responsible for more than one-third of all American jobs.³

In terms of net new jobs, small firms with fewer than 20 employees, were responsible for almost half (49%) between 1990 and 1995. Firms with fewer than 500 employees were responsible for more than three-quarters (76.5%) of net new jobs.⁴

The media typically highlights entrepreneurs in two categories: immigrant business owners and high-tech Silicon Valley start-ups. While these groups compose an important share of entrepreneurs, lesser-known entrepreneurs include those operating in the underground economy, women-owned firms, and ethnic and racial minority-owned firms.

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Figure 1
U.S. Firms by Employment Size, 1992

Figure 2
Job Growth, 1990-1994

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Underground Economy

A less obvious, but significant, population of entrepreneurs operates in the underground economy. For example, it is estimated that the underground economy is responsible for $10 billion, or 20%, of New York City’s annual economy. While some of this enterprise involves undesirable activity, such as theft, underground businesses also include domestic services, day care, car repair, etc. Unfettered by arbitrary licensing and permitting requirements, these entrepreneurs might emerge to create permanent jobs and serve as a stabilizing force in their community.

Women Entrepreneurs

“The Fifty Most Powerful Women in Business,” a recent Fortune cover story, confirmed that women have indeed come a long way in the working world. But today many women are not choosing to stake out their success in corporate America. Instead, they are seeking success in their own firms and are fulfilling their desire for more flexibility and independence. Today women-owned businesses account for one-third of all firms in the U.S. Starting one’s own business is a trend that has also been observed among a small but increasing number of women departing the welfare rolls.

The number of women-owned businesses has dramatically increased in recent years. U.S. Census figures reveal that between 1987 and 1992, the number of women-owned firms increased by 43% nationwide and employment in those firms grew by 102%. [See Figure 3.] According to the National Foundation of Women Business Owners (NFWBO), there were almost 8 million women-owned businesses in the U.S. in 1996. Estimates also reveal that the number of women-owned firms grew by 78% between 1987 and 1996 and that employment in those firms grew by 183%. Between 1987 and 1996, minority women-owned businesses grew 153% and employment increased by 276% — three times the rate of overall business growth.

Women-owned firms, which are predominately located in the service sector, account for one-third of all firms and one-quarter of employment in the U.S. It is important to note that half of all women-owned firms are located in the top 50 metropolitan areas and employ almost 10 million people.
Minority Entrepreneurs

Similarly, minority-owned firms have been increasing at a rapid pace. According to the U.S. Bureau of the Census, the number of minority-owned firms increased by 62% between 1987 and 1992. Hispanics have seen even more rapid gains with an increase of 76% over the same time period. The most significant gains were made among Hispanic women whose firms increased by 114%. Today, minority-owned firms account for about 1 in 8 firms of all U.S. firms.

Home-Based Businesses

While many more people are now telecommuting to work, there has always been a strong contingent of people operating home-based businesses. They are as diverse as mental health professionals with home-based businesses to Mary Kay cosmetics salespeople to informal child care providers. The appeal in a home-based business is often
economic — where the costs associated with commuting and renting office space can be high — or family-related, such as a desire for more family time flexibility.

One of the fastest-growing groups of home-based businesses is in the area of direct selling where individuals sell manufacturers’ and distributors’ goods and services directly to consumers.

According to the Direct Selling Association, the number of U.S. salespeople has increased from 5.7 million in 1993 to 9.3 million in 1997. Seventy percent of their more than $22 billion in sales were sold from home.¹⁵

The old adage, “Two things in life are certain: death and taxes,” may ring particularly true for our nation’s entrepreneurs as they are in a constant battle to survive both. Due to excessive taxation, businesses’ cost of labor far exceeds the actual wage paid to their employees. As business taxes rise, a greater share of resources is diverted to pay the tax bill rather than to expand the business and invest in new products and technology. Meanwhile, the increased tax burden on individuals crowds-out investment and savings that could have promoted capital formation.

Employers’ Cost of Employment

Heritage Foundation economists Mark Wilson and Angela Antonelli found that between 40 and 47 percent of the employer’s expense of hiring and keeping a worker on his payroll can be directly attributed to the costs of government taxes and mandated and optional benefits.¹⁶ Legally mandated costs include Social Security/Medicare, federal unemployment, state unemployment, and worker’s compensation. Optional mandated costs include paid leave, supplemental pay, insurance, and retirement and savings. Taxes include Social Security/Medicare and federal (including the Earned Income Tax Credit) and state income taxes.

The authors found that, in 1995, it cost all private industry employers over $17 per employee per hour to hire and keep workers on their payrolls; it cost manufacturing employers over $20; and service industry employers spent over $15. The high cost of government-mandated benefits alone accounted for almost 9 percent of employer payrolls in 1994 — up from 3.5 percent in 1951.

Payroll Tax and Other Mandated Costs

Federal payroll taxes are borne by both employers and employees to fund the federal Social Security and Medicare programs. Employers are responsible for paying 7.65 percent of employees’ wage income. (Another 7.65 percent is deducted from the employees’ income.) That means, for every one hundred dollars an employer actually pays his employee, that the employer pays more than one-hundred seven dollars. The combined employer-employee payroll tax rate has increased from 2 percent in 1937 to 15.3 percent today.

Employers are also required to purchase federal unemployment and state unemployment insurance and worker’s compensation. Depending on the state, employers can pay over 5 percent of employees’ wage income on these benefits. It is interesting to note that a strong correlation exists between unemployment insurance and increases in unemployment spells. In short, employers are forced to subsidize the activity they are insuring against, which ultimately leads to productivity losses.¹⁷

Income and Death Taxes

In comparing the original income tax in 1914 and the modern income tax in 1994, Stephen Moore of the Cato Institute found that, similar to government, the tax burden has dramatically increased. For example, the top income tax rate in 1914 was 7%. In 1994, it reached 40%. The median family faced a 0% tax rate in 1914. In 1994, it reached 28%.¹⁸ [See Table 1.] Other taxes, such as property, sales, gasoline,
alcohol, and cigarette taxes are also borne by workers and can potentially increase a family’s tax burden by more than one-third.19

<table>
<thead>
<tr>
<th>Table 1. Tax Burden: Then and Now, 1914 and 1994</th>
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<table>
<thead>
<tr>
<th></th>
<th>1914</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxes paid (bil. ’94 $)</td>
<td>6.7</td>
<td>683.4</td>
</tr>
<tr>
<td>Per capita income taxes (’94 $)</td>
<td>69</td>
<td>2,622</td>
</tr>
<tr>
<td>Individual tax filers</td>
<td>360,000</td>
<td>113,829,000</td>
</tr>
<tr>
<td>Percentage of population filing returns</td>
<td>0.5%</td>
<td>45%</td>
</tr>
<tr>
<td>IRS budget (mil. ’94 $)</td>
<td>110</td>
<td>7,100</td>
</tr>
<tr>
<td>IRS employees</td>
<td>4,000</td>
<td>110,000</td>
</tr>
<tr>
<td>Pages of federal tax law</td>
<td>14</td>
<td>9,400</td>
</tr>
<tr>
<td>Pages of IRS forms</td>
<td>4</td>
<td>4,000</td>
</tr>
<tr>
<td>Top tax rate</td>
<td>7%</td>
<td>40%</td>
</tr>
<tr>
<td>Tax rate on median family</td>
<td>0%</td>
<td>28%</td>
</tr>
</tbody>
</table>

In addition to the countless forms of taxation one must face throughout his working life, the estate tax — also known as the death tax — is particularly detrimental to small business. In order to meet the estate tax, which can exceed 50%, one-third of small business owners will be forced to sell or liquidate part of their business; half of those who must liquidate will be forced to eliminate 30 or more jobs in the process.20 This tax diverts capital away from business expansion and towards insurance and legal fees. It also creates a disincentive to business expansion. In fact, according to a recent Joint Economic Committee report, the estate tax is the leading cause of dissolution of family-run business.21

**Capital Gains Tax**

The capital gains tax imposes a heavy financial burden on private investments, thereby actively discouraging individuals from shifting capital to entrepreneurial, start-up businesses or discouraging investment altogether.

Taxing capital gains — after taxing corporate and individual income — essentially creates a “double” tax on those who invest in business formation and expansion. Furthermore, the capital gains tax is imposed on gains generated by inflation. That means that an investor whose real return is less than zero is subject to taxation on the “gain.”

**Crowd-Out**

As payroll, income, and capital gains taxes rise, less money is available for capital markets, “crowding-out” wealth and job creation in the private sector. When available resources in capital markets dwindle, entrepreneurial endeavors are hindered. In addition, higher taxes and costs on business also serve to make risk-taking activities, such as entrepreneurship, less profitable.

An individual’s available resources for starting his own business or for directing it towards a capital creation activity are diminished when his money is directed to government and away from private enterprise. Dean Stansel of the Cato Institute estimates that, even though total employee compensation has been rising, take-home pay has declined as the overall federal, state, and local tax burden is at an all-time high.22 Taxes on business and other costs on business crowd-out productivity, employment, and innovation by diverting capital away from more efficient uses of capital. This results in long-run costs to the firm and to the economy.23
Many of the same government rules that are justified as protecting the citizenry from the exploitation of “greedy” corporations and profit seekers are actually wreaking havoc on America’s entrepreneurs in virtually every segment of the economy. Federal regulations are developed, implemented, and enforced by 60 federal departments and agencies. This is in addition to state and local bureaucracies.

Spending on federal regulatory activity alone has increased dramatically over the past forty years. [See Figure 7] The most dramatic increases have occurred in the areas of environmental, social and paperwork costs.

Regulating Charity
A survey of 441 charities serving low-income communities found that 90% of charities serving the poor are hindered by government regulation. The study documents regulations ranging from the Americans with Disabilities Act to environmental
regulations to labor law. The more than one-hundred documented examples of government interference include the mandate on a Texas-based charity to use metal, not plastic, trash cans and an Oregon-based charity that was forced to close because it did not provide 24-hour nursing supervision to the homeless that were in recovery after spending time in the hospital.

**Staying Small**

Economist Thomas Hopkins has found that regulatory compliance costs are particularly onerous for smaller firms — placing them at a competitive disadvantage.25 [See Table 2.] Alternatively, Walter Olsen of the Manhattan Institute catalogued a litany of federal regulations that explains why small businesses may want to stay that way:

“Problems with the new body of law include small businesses that resolve to stay small. Occupational Safety and Health Administration regulations kick in at 10 employees, the Americans with Disabilities Act and the Civil Rights Act at 15, age bias and the health insurance continuation provisions of the Consolidated Omnibus Budget Reconciliation Act of 1986 at 20, plant-closing-notification and family-leave mandates at 50, and Employee Retirement and Income Security Act and Equal Employment Opportunity Commission reporting at 100.”26

This incentive to stay small and barriers to expansion may explain, at least in part, why the vast majority of small businesses stay small. A study by the National Association of Business Economists revealed that almost two-thirds of small firms that were still active maintained the exact same employment level in 1994 as they did in 1985.27

<table>
<thead>
<tr>
<th>Regulatory Costs per Employee for Different Size Firms, 1992</th>
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<tbody>
<tr>
<td><strong>Type of Regulation</strong></td>
</tr>
<tr>
<td>Environmental &amp; risk reduction</td>
</tr>
<tr>
<td>Price &amp; entry controls</td>
</tr>
<tr>
<td>Paperwork</td>
</tr>
<tr>
<td>All federal regulations</td>
</tr>
</tbody>
</table>

These government regulations are so pervasive that the average family is significantly impacted by their costs. According to Hopkins, federal regulations will exceed $700 billion this year — over $7,000 per household — and, absent serious reform, will continue to rise.28 [See Table 3.] Economist Richard Vedder suggests that, absent the regulatory buildup since the beginning of the Johnson administration, the nation’s GDP could have been 20 percent higher today — accounting for a $1 trillion “misunderstanding.”29

<table>
<thead>
<tr>
<th>Regulatory Costs, 1978-2000</th>
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<tbody>
<tr>
<td>(Billions of 1995 $)</td>
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</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Social Costs</th>
<th>Economic Costs</th>
<th>Paperwork Costs</th>
<th>Total Regulatory Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Environmental</td>
<td>Other Social</td>
<td>Efficiency Loss</td>
<td>Transfer</td>
</tr>
<tr>
<td>1978</td>
<td>52</td>
<td>35</td>
<td>142</td>
<td>273</td>
</tr>
<tr>
<td>1988</td>
<td>98</td>
<td>34</td>
<td>86</td>
<td>158</td>
</tr>
<tr>
<td>1998</td>
<td>188</td>
<td>62</td>
<td>78</td>
<td>143</td>
</tr>
<tr>
<td>2000</td>
<td>199</td>
<td>68</td>
<td>77</td>
<td>141</td>
</tr>
</tbody>
</table>

Table 2. Regulatory Costs per Employee for Different Size Firms, 1992

Source: Thomas Hopkins, 1996.

Table 3 Regulatory Costs, 1978-2000

Source: Clyde Wayne Crews, Jr., 1988.
Wage Laws

Despite a substantial volume of academic literature indicating that minimum wage laws reduce the employment prospects of low-skilled workers and the rapid expansion of the Earned Income Tax Credit (EITC) which subsidizes low-wage employment, federal minimum wage legislation often receives bi-partisan support in Congress. A report by the Joint Economic Committee found that minimum wage increases were particularly costly to smaller firms.\textsuperscript{30}

According to Heritage Foundation data analysis, a $1 increase in the federal minimum wage will result in the 345,000 fewer jobs in the year 2000.\textsuperscript{31} In addition, there would currently be 128,000 more entry-level job opportunities for American teens if Congress had not raised the federal minimum wage in 1996, according to labor economist D. Mark Wilson.\textsuperscript{32}

Despite the evidence, some states and localities have imposed a “living wage” — a wage higher than the federal minimum wage — which intends to provide a more substantial income to low-income workers. In a series of living wage analyses in several states, economist David A. Macpherson concluded that these misguided initiatives result in job loss for the lowest-skilled workers and they do not have a significant effect on poverty reduction.\textsuperscript{33} Furthermore, these policies could create an incentive for small businesses — and potential employers — to migrate to or establish themselves in lower-cost areas.

The 65+ year old Davis-Bacon Act requires contractors to pay workers the “prevailing wage” which is the local union-wage scale on federally subsidized projects. This law has a similar effect as the federal minimum wage law. The Davis-Bacon Act imposes additional labor costs that are borne by taxpayers. The law also imposes a heavy cost on small contractors and unnecessarily freezes out low-skilled workers.\textsuperscript{34} (Some argue that this law was originally established to exclude black workers from the construction industry.)
Other Mandated Benefits

Most economists agree that benefits are a function of salary. As the level of government-mandated benefits rises and increases the cost of each worker, the costs of these benefits are passed on to the employee through reductions in wage and salary, cutting benefits in other areas, or reducing the number of available jobs.

The Family and Medical Leave Act of 1993 extends, for up to twelve weeks, uncompensated leave to employees following the birth or adoption of a child, or to take care of seriously ill parents. Even though the law does not apply to firms with fewer than 50 employees, the law could discourage expansion or encourage intentional contraction to gain exemption from the law.

The Americans with Disabilities Act, which applies to firms with 15 or more employees, may similarly discourage business expansion. After making two of their 32 hotel rooms accessible to handicapped patrons in their hotel, Karla and Richard Hauk were charged with “unlawful discrimination by the U.S. Justice Department. The hotel lacked an elevator and ramp to the basement (defined as “occupiable space”) and non-handicapped rooms were lacking doors wide enough for wheelchair-confined visitors. (Of course, such capital improvements would also be subject to property taxes.)

Environmental

It may surprising to learn that environmental regulations can be more daunting to small businesses than taxes. According to Angela Antonelli of the Heritage Foundation, “…environmental laws, regulations, and guidances are today worse than the U.S. tax code in terms of their invasiveness, burdensomeness, and reach into the activities of businesses and individuals.”

The author of a study published by the Office of Advocacy, U.S. Small Business Administration investigated whether pollution regulation created a barrier to small business formation in the area of manufacturing. Using a longitudinal analysis, the author found that these regulations created a deterrent effect on small business establishment and that the regulations were particularly significant for smaller firms than for larger firms. The author also pointed out that environmental regulations impose higher costs by requiring more complex administrative and operational activities and created more difficult facility siting and permitting procedures.

Environmental laws that govern hazardous waste cleanup, known as Superfund, have served to hinder urban development, especially in large urban centers in industrial cities. The law’s liability scheme and strict standards for cleanup prior to property transfer encourage contaminated-site property owners to warehouse land and space that might otherwise be used for urban enterprise. For example, Superfund regulation forced a railway yard in Newark to clean its ground water to a point where it was actually cleaner that the drinking water. Warehoused land and buildings serves to undermine urban renewal goals and stifles urban regentrification.

Health and Safety

The U.S. Occupational Safety and Health Administration (OSHA) issues mandatory workplace standards, conducts on-site inspections for compliance, and imposes fines for even minor noncompliance. Economics professors Thomas J. Kneisner and John D. Leeth maintain that OSHA health and safety compliance costs business $11 billion per year, while the economic benefits of prevented injuries and fatalities may be no higher than $3.6 billion — and possibly as low as zero.

OSHA left Judy Hooper of Judy’s Bakery in Illinois with a $13,000 penalty. (Her 30-person bakery earns $50,000 in profits annually.) She was given three citations: (1) Hooper’s hazardous materials — household bleach and pink dishwashing liquid
which were clearly marked as hazardous — required a written “Material Safety Data Sheet” for “hazardous” chemicals; (2) Hooper’s first floor shop with four clearly marked exits lacked a written emergency plan; and (3) despite a perfect record, there was no accident log on the shop’s wall.

Paperwork

While there has been a concerted research effort into the area of regulation cost, less work has been conducted in the area of paperwork regulation. According to economist Thomas Hopkins, “Taxpayers are made acutely aware of the costs of government that show up in the federal budget, but they seem less sensitive to the non-budgetary costs associated with federal regulation.” Hopkins estimates that the regulatory cost of paperwork for firms was higher than either environmental and risk reduction and price and entry controls.

An employer survey, conducted by Hopkins, found that two areas were of particular concern to employers: federal tax compliance paperwork and record keeping requirements. Once again, he observed a disproportional paperwork burden on small firms.

Occupational Licensing

Proponents of occupational licensing contend that it maintains quality standards for consumers. However, a closer examination reveals that, by creating monopolies in the provision of certain services, licensing may reduce incentives to maintain quality. In fact, education and licensing requirements often exceed reasonable health or safety objectives.

The Institute for Justice’s case studies reveal that occupational licensing hindered entrepreneurial activity in a number of cities. Furthermore, the impact of these rules is significant for individuals residing in urban centers because low-risk was involved in the activity and start-up business costs are not prohibitive. Examples included licensing and rigid educational requirements for African hair braiders, manicurists, and child care providers.

Ceilings

One would likely find that most consumers would oppose placing limits on the number of grocery stores or gas stations in their community. Yet many municipalities currently limit the number of activity permits for taxicab drivers, food vendors, and newspaper stands.

By keeping the number of taxicabs, for example, artificially low, consumers are likely to face reduced available service at a higher cost. It is estimated that 40,000 are licensed to drive taxicabs in New York City, yet there are only 15,000 taxi medallions — the city permit that allows pick up and discharge passengers on the street. These rules, which limit competition and service for consumers, also hinder opportunity for many low-skilled workers.

Zoning

Home-based work is rapidly becoming a highly desirable arrangement, especially among those women who are concerned about obtaining affordable childcare services or transportation. Unfortunately, this option, the Institute for Justice found, is not available to many living in large, metropolitan areas.

In San Antonio, the city allows in-home beauty salons, but prohibits in-home barbering businesses. The city also prohibits activities including, but not limited to, furniture repair or upholstering and teaching music, art, dance or exercise to more than two students simultaneously.
In many cases, municipalities are concerned with parking issues and neighborhood traffic. In other areas, these rules are remnants of outdated concerns from decades ago, such as garment worker exploitation. Regardless of the explanation, ordinances and restrictions against home-based business are restricting options for many, particularly women who are seeking flexible schedules and who have a desire to stay at home.

*Other*

The Regulatory Flexibility Act required that agencies publish those rules that may be substantial to small business — both in terms of its economic impact and on the number of affected firms. This list includes only those rules that are expected to exceed a $100 million cost threshold. [See Table 4.] Clyde Wayne Crews of the Competitive Enterprise Institute identified over 700 such rules in 29 departments and agencies. Small business is subject to more than 4,000 additional regulations. While there was a slight decline in the number of rules between 1996 and 1997, the overall number of rules is well above the 1993 level. [See Figure 9.]

While a business will not actually encounter each of these rules, they will impose heavy costs on many small business — limiting their potential. Lawmakers should be made aware are of and understand the important impacts regulations have on both small business and on the economy. A substantial regulatory rollback could provide a down-payment on limiting the size and scope of government, while allowing America to unleash its entrepreneurial potential.

It is easy to overlook the relationship between government spending, entrepreneurship, and economic growth, especially during the longest peacetime economic expansion in America’s history. But the strong economy is exactly why it is especially important to address this relationship now.

A recent Joint Economic Committee report by Florida State University economists James Gwartney, Robert Lawson, and Randall Holcombe reveals that excessively large government — like today’s — impedes economic growth and opportunity. Government transfers and subsidies not only force taxes upward and enlarge the size of government, they also create rent-seeking, where people attempt to enhance their wealth...
by directing government benefits, such as transfer payments and subsidies, to themselves rather than engaging in the most productive activities.

When government provides a tax break to business for hiring specific types of job candidates or for setting up business in a particular geographic location, this is often viewed as tax relief. But that is only part of the story. Such subsidies might encourage a business to hire less productive employees or locate in an area that is remote from parts suppliers. In these ways, these subsidies could hinder the firm’s productivity and efficiency — at a higher cost to taxpayers.

Both of these examples could be justified as “assistance” to business formation and development. In reality, however, the firm could been better off hiring the most productive workers and locating in an efficient location. In short, government transfers and subsidies encourage business to seek gains through government largess, rather than productivity. But the damage doesn’t end there…

**Federal Business Assistance Programs**

A discussion of the barriers to entrepreneurship without also examining government efforts to assist small business would be incomplete. Government policy, even when it is not directly targeted at small business, can also serve to assist or hinder the efforts of entrepreneurs. The federal government currently operates numerous programs to assist the establishment and growth of small businesses.

In a 1995 Congressional Research Service report entitled “Federal Programs That Could Financially Benefit Enterprises,” researchers identified 177 federal assistance programs that could either provide a direct or indirect financial benefit to business enterprises. While the identified programs included programs that provide grants, direct payments, direct loans, insurance, and government loan guarantees, other types of assistance, such as advisory services, counseling, and management training, were
excluded. In addition, federal tax expenditure programs — such as tax credits, deductions, and preferential tax rates — were also excluded. These programs are administered by more than one dozen agencies and primarily benefit a small handful of business activities: agriculture (including timber), housing, marine fisheries, maritime shipping, energy, and all other businesses, particularly small and minority businesses. [See Table 5.]

### Table 5
Areas of Business Benefiting from Federal Financial Assistance Programs, 1994

<table>
<thead>
<tr>
<th>Business Activity</th>
<th>Number Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>36</td>
</tr>
<tr>
<td>Housing</td>
<td>76</td>
</tr>
<tr>
<td>Marine fisheries</td>
<td>14</td>
</tr>
<tr>
<td>Maritime shipping</td>
<td>3</td>
</tr>
<tr>
<td>Energy</td>
<td>7</td>
</tr>
<tr>
<td>All other</td>
<td>41</td>
</tr>
</tbody>
</table>


**Corporate Welfare**

When government assistance to business is targeted to a specific firm or industry, it is commonly referred to as corporate welfare. A more precise definition is provided by Cato Institute fiscal policy analysts Stephen Moore and Dean Stansel:

> “Corporate welfare can take the form of direct government grants, loans, insurance, or subsidies provided to business; trade barriers are designed to protect U.S. firms in particular industries from foreign competition at the expense of American consumers; or a loophole in the tax code carved out solely for the benefit of a particular company or industry.”

In addition to Moore and Stansel, analysts from a wide array of groups, including the Heritage Foundation and the Democratic Leadership Council-Progressive Policy Institute, agree that corporate welfare reduces economic efficiency through the loss of jobs and reduced growth. Harvard University economist Dale Jorgenson estimates that, for every additional dollar of federal government spending, there is an efficiency loss of between 30 and 40 cents from the required taxes to pay for that spending. Absent corporate welfare, the selection of “winners and losers” in the business sector would rely more on a business’ ability to meet consumers’ needs at a competitive price than on federal policy that attempts to pre-ordain them as winners — at consumers’ and taxpayers’ expense.

**The Commerce Department**

One of the hallmark proposals of the 104th Congress Republicans’ “Contract with America” included the elimination of several federal agencies, including the U.S. Department of Commerce. While this proposal has since lost steam, it was based on the premise that the agency duplicated functions in other agencies and was filled with programs that were geared toward providing corporate welfare. Of the department’s many agencies, the Minority Business Development Agency (MBDA) aims to provide assistance to small business and minority business.

The agency is charged with promoting the creation and growth of minority-owned businesses in the U.S. Their primary activity is assisting government agencies at the federal, state, and local levels and private corporations to increase their minority contracting activities. Contracting and subcontracting goals for procurement contracts to
minority- and women-owned business, known as “set-asides,” are firmly entrenched at the federal level.

The agency also funds dozens of Minority and Native American Business Development Centers around the country. While they are geared toward assisting minority and non-minority, socially or economically disadvantaged women-owned businesses, they provide technical and management assistance to businesses, without regard to size. They do this primarily by assisting these firms with securing government contracts, rather than securing private capital and developing a firm focused on competing for private sector customers.

The Small Business Administration

The Small Business Administration was created in 1953 as a temporary agency to assist small business in a number of areas, including the transition back to peacetime activities. Still around today, despite significant management problems throughout its history, the agency still receives strong Congressional support.

The agency operations include: operating a general business loan program, guaranteeing private loans to small businesses, operating a disaster loan program, administering a government contract set-aside program, operating a micro-loan program, supplementing venture capital funds for small business, and advocating for small business in the federal lawmaking process.

Advocates of the set-aside program maintain that it is important to foster the development of small business. But the questions remain: Is preparing small business for government contracting a legitimate government function? Is there a societal benefit or a benefit to taxpayers in having small business obtain government contracts? Is shielding firms from true competition beneficial for their long-term sustainability?

It is important to note that racial set-asides are often not even required to be awarded competitively. According to The National Center for Public Policy, the SBA’s racial set-aside program benefits wealthiest and well-connected firms:

“While 8(a) is supposed to benefit and train ‘disadvantaged’ firms, it actually channels contracts to just a handful of well-positioned companies. Last year [1995], more than $1 billion flowed to businesses headquartered inside the Washington beltway. In fact, the top 5 recipients all operate out of the Washington, D.C. metro area. For the last 15 years, more than half of all 8(a) participants have received no 8(a) contracts in a given year. Worse yet, a study by the General Accounting Office (GAO) found that less than nine percent of the 8(a) contracts were awarded competitively in 1994. Under 8(a)’s insipid rules, only contracts over $3 million even need to be open to competitive bidding, though that requirement for higher-end contracts is routinely ignored.”

One must also challenge the value of the agency’s loan programs. To qualify for a loan, one must first be rejected at least twice by a private funding source before receiving a SBA loan. As a result, the default rate for these programs is higher than in the private sector. Furthermore, these loan programs serve less than one percent of all small businesses.

Like many of the SBA’s functions, there is reason to believe that the agency may have outlived its usefulness. Private loans, private technical assistance, and hazard insurance are all available in the private sector. Furthermore, the set-aside program may provide lavish benefits for a select group, but it does not serve the taxpayers’ interests nor the interest of creating truly competitive firms.
As it turns out, the enormous size of government transfers and subsidies for all groups, which has dramatically increased over the last forty years, is impeding capital formation. Shifting resources away from those with higher incomes to those with lower ones also has the effects of reducing savings, rising interest rates, and declines in investments.

It is ironic that the same federal bureaucracy that undermines entrepreneurial enterprise could never itself function as a private entity. Heritage Foundation economist Angela Antonelli noted that, “If the federal government were a business, it would have declared bankruptcy a long time ago.”

Conclusion

An Agenda for Entrepreneurial Reform: The Top Five Things Lawmakers Can Do to Unleash America’s Entrepreneurial Potential

There is broad consensus among labor analysts that the vast majority of job creation occurs in small business. Even if one attributes other factors, such as demographics, technology, and consumers’ spending patterns, as the most important determinants in job creation, there is no doubt that almost all new job creation occurs in firms with fewer than 100 employees.

Unfortunately, the unchecked proliferation of federal, state, and local tax and regulatory requirements is impeding new business formation and expansion across the nation. Even well-intentioned government-sponsored programs that aim to spur business formation and economic development are destroying economic opportunity for our nation’s families.

Removing obstacles and reducing the regulatory and tax burdens on small business could have a substantial, positive impact on the ability of small business to facilitate job creation. Lawmakers have a unique opportunity to unleash America’s entrepreneurial potential. The current strong economy, coupled with a large budget surplus, provides lawmakers with many options, including:

Abolishing the minimum wage and living wage laws. It is time for federal, state, and municipal lawmakers to recognize that, however well-intentioned, these misguided initiatives result in job loss for the lowest-skilled workers and they do not have a significant effect on poverty reduction.

Abolishing the capital gains tax. This tax imposes a heavy financial burden on private investments, thereby actively discouraging individuals from shifting capital to start-up businesses or discouraging investment altogether. Moreover, taxing capital gains — after already taxing corporate and individual income — creates a “double” tax on those who invest in business formation and expansion, “crowding-out” wealth and job creation in the private sector.

Abolishing estate taxes. The “death” tax can exceed a rate of 50 percent, forcing one-third of small business owners to sell or liquidate part of their business to pay this tax, with half of those liquidated firms eliminating 30 or more jobs in the process.

Regulatory moratorium and rollback. The total economic burden for regulatory compliance on the federal level alone is now $700 billion annually, or $7,000 per household. Absent any meaningful reform, that figure will continue to rise. It is not enough to merely hold the line on new regulations. Federal, state, and municipal lawmakers should commit to reducing the regulatory burden on entrepreneurs by sunsetting regulations through automatic termination unless legislators determine a regulation is still necessary.
Cutting taxes and government spending, including corporate welfare. The greatest opportunity individuals have to keep more of their own money, the more conducive this will be to business formation and expansion. Cutting $1 trillion in taxes — financed by the budget surplus — and eliminating corporate welfare would be good places to start.

The selection of “winners and losers” in the business sector should be determined by a firm’s ability to meet consumers’ needs at a competitive price than on federal policy that attempts to pre-ordain them as winners — at consumers’ and taxpayers’ expense. Stephen Moore of the Cato Institute recently crystallized these important opportunities that are lost when government “assists” private industry.

“If all corporate welfare were eliminated, the savings would be large enough to entirely eliminate the capital gains tax or the death tax. [See Table 6.] Private industry recipients of corporate welfare typically boast of the jobs that they create with their federal grant payments. It makes sense that if Congress gives General Electric a cash payment, they may use those dollars for socially useful purposes. But the real issue with corporate welfare is what are the opportunity costs associated with the $75 billion a year in corporate subsidies…Those in the business community who contend that corporate subsidies add to America’s competitiveness and industrial might, must answer the following question: Do you really believe that these programs add more wealth, jobs, or venture financing for the American economy than would entirely eliminating the capital gains tax or adopting a low-rate flat tax that ends all punitive tax treatment of savings? Very few could honestly answer that question in the affirmative.”

<table>
<thead>
<tr>
<th>Corporate Welfare Alternatives</th>
<th>Annual Cost</th>
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<tr>
<td>Eliminate Capital Gains Tax</td>
<td>$70 billion</td>
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<tr>
<td>Eliminate the Death Tax</td>
<td>$25 billion</td>
</tr>
<tr>
<td>Cut Corporate Tax from 35 percent to 25 percent</td>
<td>$65 billion</td>
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<tr>
<td>Cut All Personal Income Tax Rates by 10 Percent</td>
<td>$74 billion</td>
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<tr>
<td>Establish 20 Percent Flat Tax</td>
<td>$65 billion</td>
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<tr>
<td>3 Percentage Point Cut in Payroll Tax</td>
<td>$70 billion</td>
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Table 6. What $75 Billion In Annual Corporate Welfare Savings Would Buy


America’s strong entrepreneurial tradition has been for many the pathway to the American dream. It is a national disgrace that intrusive Big Government is strangling this nation’s long-standing, deeply-rooted spirit of entrepreneurship.

If America is to remain competitive, innovative, and vibrant in the next century, we must be prepared to foster small business formation and expansion. The best way to do that is not through top-down government approaches. The best approaches lie in allowing individuals to direct their resources toward private enterprise and in allowing entrepreneurs to succeed and fail on their own merits — not because of stifling regulations and wasteful government programs.
Endnotes

33. The series was conducted on behalf of the Employment Policies Institute in Washington, D.C.
35. Employers are required to continue health insurance contributions during the leave.
44. Thomas D. Hopkins, “Regulatory Costs in Profile,” Center for the Study of American Business, Policy Study, no. 132, August 1996. The author defined paperwork regulation to include “tax compliance procedures and paperwork requirements not having a direct social or economic function; the cost of paperwork is largely the value of time that businesses and consumers must devote to paperwork.”
Naomi Lopez is director of both the Center for Enterprise and Opportunity and the Project on Children at the Pacific Research Institute in San Francisco. She has conducted research and analysis on major federal and state health and welfare programs, children’s issues, women’s issues, barriers to entrepreneurship, Social Security privatization, and tax expenditure programs. Prior to joining the Institute, Lopez worked as a research associate specializing in health care and welfare at the Institute for Socio-Economic Studies in White Plains, New York and as an entitlements policy analyst at the Cato Institute in Washington, D.C. She also served as special policy advisor to the state of Michigan’s Secchia Commission, which provided recommendations for state government reform. A frequent media guest, Lopez has appeared on ABC’s Politically Incorrect, PBS, CNN, CNBC, FOX News Channel, and MSNBC. Lopez is editor of and contributor to the Legislators’ Guide to Children’s Issues 1999 (Pacific Research Institute, 1999) and her articles have appeared in Investor’s Business Daily, Washington Times, San Diego Union-Tribune, Chicago Tribune, and Insight. Lopez holds a B.A. in economics from Trinity University in Texas and an M.A. in government from the Johns Hopkins University.

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