

**THE ROLE OF SMALL BUSINESS IN THE  
NATION'S ECONOMIC RECOVERY**

MONDAY, MARCH 9, 1981

U.S. SENATE,  
SELECT COMMITTEE ON SMALL BUSINESS,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

Present: Senators Weicker, Gorton, and Rudman.

Also present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; James J. O'Connell, economist; G. Thomas Cator, economist, minority; and Margaret M. Broadbin, hearing clerk.

**STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR  
FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, SENATE  
SMALL BUSINESS COMMITTEE**

Senator WEICKER. The meeting of the Small Business Committee will come to order, the hearing being on the role of small business in the Nation's economic recovery.

I have a statement that I am going to place in the record so we may hear the comments of those who made a great effort to be with us here this morning.

[The prepared statement of Senator Weicker follows:]

OPENING STATEMENT OF  
SENATOR LOWELL WEICKER, JR., CHAIRMAN  
SMALL BUSINESS COMMITTEE  
HEARING ON THE ROLE OF SMALL BUSINESS IN THE  
NATION'S ECONOMIC RECOVERY

THE SENATE SELECT COMMITTEE ON SMALL BUSINESS BEGINS TODAY WHAT I EXPECT AND FULLY INTEND WILL BE A LONG PROCESS OF INVOLVEMENT IN THE ECONOMIC POLICY DELIBERATIONS OF THIS CONGRESS.

THE PRESIDENT IS RIGHT, IN MY JUDGMENT, TO BE GIVING A TOP PRIORITY IN THESE EARLY DAYS OF HIS ADMINISTRATION TO OUR VERY GRAVE ECONOMIC PROBLEMS, INCLUDING PERSISTENT SEVERE INFLATION, OVERLY HIGH INTEREST RATES, AND FEDERAL GOVERNMENT TAX AND REGULATORY POLICIES THAT ARE ACTUALLY STIFLING -- RATHER THAN ENCOURAGING -- CAPITAL INVESTMENT AND PRODUCTIVITY.

I THINK THERE IS GENERAL AGREEMENT THAT FOR ANY ECONOMIC RECOVERY PLAN TO BE SUCCESSFUL, WE MUST REDUCE INFLATION, SPUR CAPITAL INVESTMENT AND ENCOURAGE INCREASED PRODUCTIVITY AND JOB CREATION.

THE PURPOSE OF OUR HEARING THIS MORNING IS TO CONSIDER THE ROLE SMALL BUSINESS OUGHT TO HAVE IN HELPING TO BRING ABOUT THOSE RESULTS.

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I BELIEVE STRONGLY THAT SMALL BUSINESS SHOULD HAVE A VERY DEFINITE ROLE IN THE ECONOMIC RECOVERY -- NOT BECAUSE SMALL BUSINESS DESERVES IT, BUT BECAUSE OUR COUNTRY DESERVES TO HAVE THE CONTRIBUTION OF SMALL BUSINESS. WHAT NEEDS TO BE RECOGNIZED IS SMALL BUSINESS' TRACK RECORD IN REACHING THOSE OBJECTIVES I JUST MENTIONED. FOR YEARS, SMALL BUSINESS HAS ACCOUNTED FOR NEARLY HALF OF U. S. TOTAL OUTPUT, VIRTUALLY ALL NEW PRIVATE SECTOR JOBS, AND ABOUT HALF OF ALL NEW INNOVATION.

THE DIFFICULTY NOW, OF COURSE, IS THAT SMALL BUSINESS IS UP AGAINST SOME PRETTY SEVERE ECONOMIC PROBLEMS. EVERYTHING PRESIDENT REAGAN SAID RECENTLY ABOUT OUR CURRENT ECONOMIC SITUATION IS DOUBLY TRUE FOR SMALL BUSINESS. NO ONE FEELS THE PINCH OF INFLATION -- WHICH HAS DRIVEN UP LABOR, MATERIALS AND ENERGY COSTS -- OR SKY-HIGH INTEREST RATES, MORE THAN SMALL BUSINESS. MOREOVER, SMALL BUSINESS MUST WORK WITHIN A TAX STRUCTURE THAT FAILS TO OFFER ADEQUATE INCENTIVES FOR CAPITAL FORMATION AND RETENTION. UNLESS WE OBTAIN SOME RELIEF FROM THESE PROBLEMS, THE ABILITY OF SMALL BUSINESS TO CONTINUE MAKING ITS IMPORTANT CONTRIBUTION TO OUR ECONOMY WILL BE JEOPARDIZED.

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FOR THIS REASON, I BELIEVE WE NEED TO BE SURE THAT OUR ECONOMIC RECOVERY POLICIES ARE SHAPED SO AS TO MAXIMIZE THE OPPORTUNITIES FOR SMALL BUSINESS TO BE MORE PRODUCTIVE, TO CREATE MORE JOBS, AND TO CONTINUE TO BE INNOVATIVE. ANY SUCCESSFUL ECONOMIC RECOVERY PLAN, IN MY OPINION, IS GOING TO HAVE TO BE CRAFTED IN A WAY THAT TARGETS TAX REDUCTION AT THOSE ECONOMIC GROUPS WITH THE POTENTIAL TO MAKE THE GREATEST AND QUICKEST RESPONSE IN TERMS OF PRODUCTIVITY AND CAPITAL INVESTMENT.

IT'S MY BELIEF THAT SMALL BUSINESS IS REALLY THE ESSENCE OF SUPPLY-SIDE ECONOMICS AND THAT -- GIVEN THE PROPER INCENTIVES AND RELIEVED OF EXISTING ECONOMIC ROADBLOCKS -- IT WILL RESPOND SWIFTLY IN A WAY THAT WILL PRODUCE GREAT BENEFITS FOR THE ENTIRE ECONOMY.

I LOOK FORWARD TO HEARING FROM OUR FINE WITNESSES THIS MORNING AND I HOPE THIS HEARING WILL GIVE US A BASIS TO PROCEED FURTHER IN THE DEVELOPMENT OF AN APPROPRIATE POLICY FOR SMALL BUSINESS AND FOR OUR ECONOMY.

Senator WEICKER. Our first panel consists of Mr. Arthur Levitt, chairman of the American Stock Exchange. Are you "former" head of the White House Conference on Small Business or are you still the chairman of the Conference?

Mr. LEVITT. No, I think it's former.

Senator WEICKER. Whatever the case is, you're a good chairman.

Mr. LEVITT. Thank you.

Senator WEICKER. With him is Mr. Melvyn Klein, president of the Altamil Corp. of Corpus Christi, Tex., and Mr. John Chalsty, managing director of Donaldson, Lufkin & Jenrette of New York.

Gentlemen, the floor is yours. As much as possible, I would like to remain within the confines of certain time allocations during the course of this hearing so that everybody can be heard, and be heard carefully, and so we will not have to rush through the latter part of the meeting.

Arthur, why don't you start off? You certainly have been a great prime mover of focusing attention on small business and its needs, particularly in the area of capital formation and tax incentives. It is a delight to have you here with us this morning.

**STATEMENT OF ARTHUR LEVITT, JR., CHAIRMAN, AMERICAN STOCK EXCHANGE, NEW YORK, N.Y.**

**Mr. LEVITT.** Thank you, Mr. Chairman.

I might say that long before it became fashionable to be involved in the small business area, you were leading that fight. You brought the first hearing of any Senate committee to the American Stock Exchange several years ago.

Small business all over the Nation owes a great debt of gratitude to you for your efforts. I hope they will continue.

I'm chairman of the American Stock Exchange. I represent its listed companies, its member firms, as well as the individual investors who make up 70 percent of the business that is done on our exchange.

The companies on whose behalf I am here today—the creative, innovative, risk-taking smaller and mid-range companies—are our Nation's best hope for economic growth. The financing of these companies is substantially drawn from individual investors. Therefore, they are dependent on the kind of economic climate which encourages risk-taking with a favorable reward ratio.

At this point I am sure we can agree that there is no easy solution to the economic problems confronting the Nation. Their scope and their complexity increases every day.

It used to be that double-digit inflation rates occurred in other nations that seemed to be unable to manage their economic affairs. Today double-digit inflation has become a brutal, compelling fact of life in this country and raises serious, legitimate doubts about our own economic future.

It is vital that we adopt a comprehensive, coherent strategy to restore stability to our economy. The program which President Reagan has submitted to the Congress, I believe, is a giant step in that direction.

In my view, the Congress, working with the Reagan administration, should implement an economic program for the decade of the 1980's which includes four essential principles.

First, Federal spending and the ability of the Federal Government to mandate private spending for public purposes should be restrained.

There was no initiative of the White House Conference on Small Business that so obsessed the delegates as the question of bringing our budget back into balance.

Second, the tax code should be changed to provide incentives for greater savings and investment.

Third, the tax code should be altered to provide incentives to stimulate greater research and development. This latter element is something that I think is lacking from the administration's program.

Fourth, the tax code should be reformed to encourage a more efficient, effective, and productive use of private saving.

President Reagan has demonstrated considerable political courage in submitting an economic program which goes a long way toward obtaining the first objective. Budget restraint is clearly an idea whose time has come.

It has come rather late in the game, but at least it has arrived. The administration has proposed it. I have a feeling that the Congress strongly supports it. And the American people are demanding no less.

It is not going to be a simple or painless process. Moreover, budget restraint is no magical potion to cure inflation. However, it will have an enormous and favorable psychological impact on our economy.

The second target for action is the encouragement of savings and investment. Mr. Chairman, as you know, we have the lowest rate of savings of any industrialized democracy. We also invest a smaller percentage of our gross national product than any of our major industrial trading partners.

Thoughtful people of all political persuasions are coming to the inevitable conclusion that the standard of living of the average American will necessarily decline unless we improve our economy's productivity performance during the next decade. That cannot be accomplished unless we increase the incentives for individuals to save and for business to invest.

One of the greatest legislative success stories in recent memory was the reduction in 1978 of the maximum capital gains tax for individuals from 49 to 28 percent and the statutory corporate capital gains tax from 30 to 28 percent.

The 1978 capital gains tax cut has encouraged individuals to invest in America, reversing the trends of the preceding years of the 1970's when well over 10 million Americans deserted our equity markets to invest in such nonproductive areas as precious metals and exotic collectibles.

The 1978 cut has also had a significant effect on the new issues market. Estimates indicate that in 1980 new capital raised through initial stock offerings rose to about \$1.35 billion. This compares to a yearly average of less than \$225 million in new issues for the 3 years going back prior to 1978.

I believe that a further reduction would continue this process of unlocking sources of capital as well as stimulating growth.

The tax bill passed by the Senate Finance Committee last year raised the capital gains exclusion from its present level of 60 to 70 percent for noncorporate taxpayers.

On January 6 of this year, Senators Malcolm Wallop and Daniel Patrick Moynihan introduced a bill which is descriptively numbered S. 75. This provides a 75-percent capital gains exclusion for individuals. This reduces the maximum effective capital gains rate for individuals from 28 to 17.5 percent.

I strongly endorse the approach taken by the Senate Finance Committee and embodied in the Wallop/Moynihan bill. While obviously there are a number of alternative ways to lower capital gains tax rates for individuals, I believe that in increasing the exclusion we provide a simple straightforward way to reduce not only the maximum rate but also the rate to the middle-income small investor.

I also want to take this opportunity to express support for several other tax proposals to encourage capital formation for small business which were selected as top priorities by the delegates to the White House Conference on Small Business, and which you and your committee have submitted for the Senate's consideration in S. 360.

Those I would like to single out—all of which I have previously supported in testimony before this committee—include a 10-percent tax credit for investment in new issues of smaller corporations, a concept which the American Stock Exchange proposed 3 years ago and which you, Mr. Chairman, have developed and given broad visibility to; and the creation of a small business participating debenture as originally proposed by Arthur Andersen & Co.

The third area in which I believe congressional action is important is the encouragement of research and development.

Mr. Chairman, a national economic strategy for the 1980's must focus on the central problem of productivity. There is a vigorous and healthy debate going on within the economic profession regarding the problem of quantifying with some precision the causes of our weak productivity performance.

There is an obvious logical link between a society's productivity and its capacity to create and rapidly adapt. It is also clear that a disproportionately large amount of creation and development of a new technology is done by the smaller and midrange companies.

Our major international competitors actively promote industrial R. & D., and it is paying off for them. For example, Japan targets high potential industries with developmental subsidies, accelerated depreciation, and soft loans for R. & D. All businesses are allowed a 20-percent tax credit for R. & D., tax-free cash grants for investment in R. & D. facilities, and special depreciation for R. & D. plant equipment. Our country has no such incentives.

Mr. Chairman, I urge this committee to give careful consideration to the provision of last year's Finance Committee bill which provided for a tax credit equal to 25 percent of the increased R. & D. expenditures made by a firm over their average R. & D. outlay for the previous 3 years.

The authors of that provision, Senators Danforth and Bradley, deserve support once again for this excellent idea.

Fourth, we must encourage a more efficient, effective, and productive use of private savings by reducing the tax on so-called unearned income. The aggregate savings level in this country is too meager to waste any on unproductive investment.

That is precisely what happens when the Federal Government imposes a tax rate which is virtually confiscatory. It is essential that investment decisions be made on the basis of the economic viability of a particular project rather than to avoid paying a 70-percent marginal rate.

For this reason, I support an immediate reduction in the maximum rate to 50 percent. This, of course, would automatically lower the maximum capital gains tax rate as well.

Mr. Chalsty, Mr. Klein, and I, and I'm sure all of the other witnesses who will be here today, are appearing before you because we believe that small and growing businesses can provide the rejuvenation that our economy needs.

This committee of all committees has taken an open-minded and creative approach by holding these hearings at the very start of the legislative session, to create an agenda and build support for legislative action for small business.

I think that all of us recognize that we can no longer afford to hang on to the heavy baggage of old economic theories as we try to tackle the complex problems facing our economy today. We need new ideas. We need new approaches that deal with today's reality. We need to challenge the so-called conventional wisdom.

I really hope that both the administration and the Congress continue to focus on the long-term requirements of the American economy in this increasingly interdependent and competitive world even as shortrun brushfires are extinguished.

I might say that the business community has an opportunity today that it has not had in many years. If we squander that opportunity through arrogance or stupidity or overconfidence, I think we may not see this once more for the next 50 years.

You can count on the enduring support of the American Stock Exchange as well as the newly-formed American Business Conference in your efforts over the years to reverse our problems and to rebuild the Nation's economic strength.

Thank you.

Senator WEICKER. Thank you very much, Arthur.

I will save the questions until everyone has had a chance to speak.

All statements will be included in their entirety in the record.

Any subsequent witnesses can submit their entire statement and then synopsise so we can allow the maximum amount of time for questions.

In other words, I think we are here with questions that we want to throw at you in the sense of finding out the opinions of the small business community. I would hope that others would keep that in mind.

[The prepared statement of Mr. Levitt follows:]