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Why is Small Business the Chief Business of Congress?

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WHY IS SMALL BUSINESS THE CHIEF BUSINESS OF CONGRESS?

*Mirit Eyal-Cohen**

Abstract

Small business is a sacred cow in America. In 1958, Congress created the Small Business Investment Company ("SBIC"), a unique public-private program that provides long-term capital to small business enterprises. From its inception, however, the SBIC has been plagued by inefficiency and failure. Yet, Congress continues to pour millions of dollars into the SBIC program, with no end in sight. What explains this failed policy course?

This article argues that many small business programs today are locked in due to heavy investment by our legal system that outweighs any advantages from possible change. Over the years, path dependency through increasing returns of small business preferences occurred as the benefits of

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this choice augmented simply because over time more people opted for that choice.

The SBIC program is one example of the pitfalls of legal and political institutional path dependency of small business preferences and should be replaced by private institutional lending system. Pursuant to this account, our romantic ideal of small business as an economic and social catalyst has sprouted positive cultural feedbacks. Thereafter, Political small business institutions such as the House and Senate Small Business Committees and the Small Business Administration sustained this culture, self-reinforcing inefficient paths of small business favoritism where we remain invested to this day.

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I. INTRODUCTION

Under current definitions 97% percent of all corporations are small.¹ When the recent economic recession struck, the acute impact of the credit freeze on small businesses became a political rallying cry.² Senator Mary L. Landrieu (D-LA) declared that “[s]mall business in America needs a champion in Washington right now,” while Senator Maria Cantwell (D-WA) demanded to know “[w]hen are we going to stand up for small businesses in America who have had trouble getting access to . . . capital, who have been penalized?”³ To bridge the equity gap, namely the disparity between long-term finance demand and the supply of loans or equity-type credit,⁴ Congress

1. Between 1944 and 2007, 97% or more of all corporation returns were of those with assets of \$5 million or less. See INTERNAL REVENUE SERVICE, CORPORATION SOURCE BOOK OF STATISTICS OF INCOME (Jan. 23, 2012), <http://www.irs.gov/taxstats/bustaxstats/article/0,,id=112834,00.html>. Defining a “small business” has long been considered “a daunting task that requires capturing a moving target.” OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., THE SMALL BUSINESS ECONOMY FOR DATA YEAR 2006: A REPORT TO THE PRESIDENT 9 (2007), available at http://www.sba.gov/advo/research/sb_econ2007.pdf. The Small Business Act of 1958 crudely defines a small business as an enterprise that is “independently owned and operated and which is not dominant in its field of operation.” Pub. L. No. 85-536, § 3, 72 Stat. 384, 384 (1958) (codified in 15 U.S.C. § 632(1) (1998)). But the modern approach more specifically examines the number of employees or average annual receipts. See, e.g., U.S. SMALL BUSINESS ADMINISTRATION, *Summary of Size Standards by Industry*, SBA.GOV, <http://www.sba.gov/content/summary-size-standards-industry> (last visited April 13, 2012) (defining small manufacturing and mining enterprises as having five hundred or fewer employees); Small Business Size Regulations, 13 C.F.R. § 121-201 (2011) (providing for size eligibility provisions and standards for small business in each industry). See also Mirit Eyal-Cohen, *When American Small Business Hit the Jackpot: Taxes, Politics, and The History of Organizational Choice in the 1950s*, 6 PITT. TAX REV. 1, 6 (2008) (examining history of the “small business” definition).

2. See, e.g., Ylan Q. Mui, *With Bank Credit Frozen, Small U.S. Businesses Starting to Turn to Microlenders*, WASH. POST, Mar. 8, 2010, at A09.

3. Press Release, U.S. Senate Committee on Small Business & Entrepreneurship, LeMieux, Landrieu, Senate Democrats Fight to Include Credit Relief for Small Businesses (Jul. 22, 2010) (on file with author) (statement of Sen. George LeMieux (R-FL)) (“One of the biggest hurdles is the ability for [small] businesses to secure loans or investors.”); 150 CONG. REC. H2921, 2968 (daily ed. May 13, 2004) (statement of Rep. John Tierney (D-MA)) (“As a person in a small business and representing a number of small businesses for over 22 years, I can tell you small business employers do not want an inferior policy for their employees.”).

4. The equity gap is especially acute for small business managers because they are often denied credit due to the fact that they do not have enough equity base, collaterals or “hard assets.” This is especially true for small business in the services industry (such as software companies), which do not have an equity base wide enough to secure loans and credit. For a general description of the equity gap see ERIC N. WEISS, GOV’T & FIN. DIVISION, CRS REPORT FOR CONGRESS: ECONOMIC FACTORS AFFECTING SMALL BUSINESS LENDING AND

enacted a set of economic stimulus initiatives that introduced larger tax breaks for small businesses, increased the lending authority of the Small Business Administration (“SBA”), and spurred lending through the Small Business Investment Company (“SBIC”) program.⁵

Distilled to their essence, the recent initiatives to help small businesses are just old wine in new bottles. They were a continuation of a pattern established decades earlier. Just before the onset of the Great Depression, President Calvin Coolidge proclaimed that “[t]he chief business of the American people is business.”⁶ That mantra eventually was appropriated by small business. The creation of the SBIC program in 1958 was intended to stimulate economic activity by creating jobs and assisting in the national economic recovery. But what originally was meant to be a remedy inadvertently set into motion a path of waste that Congress has sustained now for over half a century. The fault, however, does not lie exclusively with politicians. They have been locked into this position because society has become enamored with the idea of small business. That romantic ideal has taken root within a myriad of legal organizations, and can no longer be easily undone.

Most notable, the SBIC, through which the SBA has channeled some small business funding, epitomizes how public-sector initiatives can fail within the private sector. For decades, the SBA has licensed the use of partnerships, LLCs, and corporations to make long-term loans and equity participation to small businesses.⁷ These SBICs have been propped up even

LOAN GUARANTEES 1, 7 (2008) (reviewing demand and supply for business loans, and the impact of economic slowdown on small business lending and loan guarantees).

5. For an explanation on the SBIC see *infra* note 7 and accompanying text. See also American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (establishing tax incentives for businesses and SBICs); *State of the Small Business Economy and Identifying Policies To Promote Economic Recovery: Hearing Before the H. Comm. on Small Business*, 111th Cong. 85 (2009) (examining the status of small businesses financial situation, and proposing federal policies to promote small business development and economic growth).

6. President Calvin Coolidge, *Address Before the American Society of Newspaper Editors* (Jan. 17, 1925), in JOHN BARTLETT, *FAMILIAR QUOTATIONS* 614 (Justin Kaplan ed., 16th ed. 1992).

7. See 15 U.S.C. § 681 (2010) (“A small business investment company shall be an incorporated body, a limited liability company, or a limited partnership organized and chartered or otherwise existing under State law solely for the purpose of performing the functions and conducting the activities contemplated under this subchapter . . . [and] subject to the approval of the Administration.”).

further by federally guaranteed loans,⁸ as well as a myriad of preferential treatment and concessions from the government,⁹ all for the express purpose of encouraging investment in small business. Indeed, this expansive and sustained commitment by the government to the SBIC program has earned it the moniker of a “fourth banking system.”¹⁰

And, by most accounts, this system is entirely broken.¹¹ Studies of the SBIC program have found it has generated limited profits and incurred considerable losses to the federal government,¹² thereby failing to provide

8. These loans can amount up to half of an SBIC’s paid-in capital. *See, e.g.*, Small Business Investment Act of 1958, 15 U.S.C. § 633 (1958) (“The Small Business Investment Act of 1958”).

9. One of the preferential tax treatments the government grants investors in SBICs includes full deductibility of dividends from SBICs by the receiving corporation. 26 U.S.C. § 243 (2009). Losses up to \$100,000 from sale of stock of an SBIC are treated as ordinary losses, and thus deductible against ordinary income, which is taxed at higher tax rates. Special non-recognition gain rules also permit investors to roll over publicly traded stock gains into SBICs without paying capital gain taxes. *See id.* §§ 1242, 1044. Moreover, other government agencies have eased the regulatory burden on SBICs and provided them with more flexible rules. *See, e.g.*, Allan F. Conwill, *Protection or Oppression? The Investment Company Act Impact on the Publicly Held SBIC*, SEC.GOV (Oct. 3, 1963), <http://www.sec.gov/news/speech/1963/100363conwill.pdf>.

10. ADDISON W. PARRIS, *THE SMALL BUSINESS ADMINISTRATION* 150 (1968) (describing the SBIC as an addition to the existing “three traditional financial institutions in the United States—the commercial banks, savings institutions, and investment banks.”).

11. The SBIC program received little attention from legal scholars, who mostly criticized its persistence. *See, e.g.*, Jess H. Darrin, *Minority Enterprise Development and the Small Business Administration’s Section 8(a) Program: Constitutional Basis and Regulatory Implementation*, 49 *BROOK. L. REV.* 433, 472–73 (1983); Joseph W. Bartlett, *Government-Enhanced Equity Available for Investment in Traditional Venture Capital and Buyouts: The New SBIC Participating Securities Program*, 1994 *COLUM. BUS. L. REV.* 589, 612–15 (1994) (arguing that the SBA’s SBIC participating securities program is inadequate to handle small business financing); John W. Lee, *Critique of Current Congressional Capital Gains Contentions*, 15 *VA. TAX REV.* 1, 16 (1995) (criticizing the contention behind granting investors in SBICs tax preferences such as the one found in section 1044); Dr. Jeffrey Robinson, *Current Issues in Community Economic Development: Urban Entrepreneurship: Patterns and Policy*, 30 *W. NEW ENG. L. REV.* 103, 110–11 (2007) (generally stating that federal programs have used a capital access-driven strategy to address business development); Brian Krumm, *Understanding the New Tennessee Small Business Investment Company Credit Act: Stimulating Economic Growth at the Intersection of Free Market Capitalism and Government Intervention*, 11 *TRANSACTIONS: TENN. J. BUS. L.* 93, 93–95 (2010) (providing background for the new Tennessee Small Business Investment Company Credit Act and reviewing the possible problems associated with the act’s emphasis on seed and early stage financing).

12. *See, e.g.*, Elijah Brewer III et al., *A Trojan Horse or the Golden Fleece? Small Business Investment Companies and Government Guarantees* 1 (Fed. Reserve Bank of Chicago Working Paper Grp., Paper No. WP-97-22, 1997), *available at*

sufficient capital to spur significant assistance to small business.¹³ Further, the program conducts minimal review of its loan recipients, and involves bureaucracy on an order that deters many venture capitalists.¹⁴ And the various exemptions and tax concessions granted to SBICs contribute to the increasing complexity of the legal system and compound the already elevated compliance costs of small business entities.¹⁵

But the program's survival, much less its problems, is a historical accident. When the SBIC program was introduced in 1958, it was chosen from a set of alternatives to support small business available at that time.¹⁶ Since that path was chosen, Congress repeatedly renewed the program in all of its inefficient infamy. And each and every subsequent session of Congress has expanded the SBIC program, adding to the monolithic waste that persists to this day.

One explanation for the program's persistence may simply be politics.¹⁷ Pursuant to public choice theory, politicians arguably have been beholden to the interests of their constituents,¹⁸ many of whom own, operate, or work for a small business; and, indeed, there is some historical evidence to this effect.¹⁹ Further, the exalted status of small business as a bedrock of America

http://www.chicagofed.org/digital_assets/publications/working_papers/1997/wp97_22.pdf. (reviewing the state of the small business investment company program).

13. See, e.g., Steven L. Brooks, *The Venture Capital Investment Act of 2001: Arkansas's Vision for Economic Growth*, 56 ARK. L. REV. 397, 402 (2003) (reviewing venture capital under Arkansas law as an attempt to stimulate economic growth).

14. See, e.g., JOSH LERNER, BOULEVARD OF BROKEN DREAMS: WHY PUBLIC EFFORTS TO BOOST ENTREPRENEURSHIP AND VENTURE CAPITAL HAVE FAILED — AND WHAT TO DO ABOUT IT 38–39 (2009) (detailing the inherent problems with the SBIC program today).

15. See, e.g., C. Steven Bradford, *The Cost of Regulatory Exemptions*, 72 UMKC L. REV. 857, 863 (2004) (exploring the costs associated with small business regulatory exemptions); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept: Current Developments And Emerging Issues*, 20 B.C. L. REV. 225, 233–35 (1979) (discussing the cost to the government of the forgone revenue associated with tax preferences).

16. See, e.g., H.R. 10345, 85th Cong. (1958) (proposal by John Wright Patman (D-TX) to form a small business capital banks system).

17. Ronald F. Wilson, *Federal Tax Policy: The Political Influence of American Small Business*, 37 S. TEX. L. REV. 15, 28 (1996) (discussing the influence of small business organizations).

18. Philip Shabecoff, *S.B.A. Under Fire: Program To Assist Minorities Discounted*, N.Y. TIMES, May 16, 1971, at F3; Irwin L. Kellner, *A Bright Forecast for Small Businesses*, N.Y. TIMES, June 24, 1984, at L120 (avowing to the notion that the business of our country is small business).

19. See, e.g., Eyal-Cohen, *supra* note 1, at 17, 21 (demonstrating how lobbying efforts and rhetoric were some of the factors that influenced the creation of the Small Business Corporation in 1958).

perhaps insulates the SBIC program; no politician wants to be seen attacking “Main Streets across America”²⁰ and taking money away from small businesses that are regarded popularly as “the engine of job creation in this country.”²¹

Politics, however, cannot entirely explain the complex history of the SBIC program. That program is one of many divisions of the SBA, which has seen its lending authority constricted in numerous ways over the years.²² In contrast, the SBIC program has remained largely intact and even expanded in the name of a myriad of social purposes.²³ The missing piece of this puzzle lies in path dependence theory.²⁴

This article examines through the prism of social history the legal and political institutional path dependency of small business favoritism. Part II of this article provides a general account of the path dependence theory as applied in a political realm. Part III demonstrates how our romantic ideal of small business has sprouted positive cultural feedback. That positive feedback portrayed our belief in democratic free-enterprise society and small

20. Press Release, U.S. Senate Committee on Small Business & Entrepreneurship, *supra* note 3 (statement of Sen. Patty Murray (D-WA)).

21. *Id.* (statement of Sen. Amy Klobuchar (D-MN)). *But see* Alex Labeau, Op-Ed., *IACI: Beware Politicians Who Tout Small Biz*, THE SPOKESMAN-REVIEW, July 19, 2010, at 1 (“In reality, the real cynical political motivation for touting ‘small business’ is to create an ‘us versus them’ mentality that is not only a misrepresentation of reality, but a dangerous path of rhetoric that leads to an economic caste system.”). *See generally* Douglas Holtz-Eakin, *Should Small Businesses Be Tax-Favored?* 48 NAT’L TAX J. 387, 387 (1995) (asserting that constructing a case of systematic favoritism of small businesses is quite difficult, especially through the tax code); *see also* Wilson, *supra* note 17, at 68 (estimating the cost of annually subsidizing small business to be \$5 billion); *see also infra* Part III.

22. *See, e.g.*, discussion *infra* Part III.B (proposals to limit and even abolish the SBA in Reagan’s administration).

23. *See infra* Part III. *But see, infra* note 278, The SBIC Participating Securities Program has been cancelled in 2004 and there have been recent proposals to reinstate this program due to increased need of supply of venture capital investments to small business. *See, e.g.* H.R. 5297, the Small Business Jobs and Credit Act of 2010, which would have authorized a \$1 billion Small Business Early-Stage Investment Program. 156 Cong. Rec. Daily H4608, H4609 (June 17, 2010).

24. *See, e.g.*, Lucian Aye Bacchus & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 127 (1999) (applying path dependence theory to initial choices by business ownership structures); Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 604 (2001) (arguing that *stare decisis* is a path dependent legal doctrine); Paul Pierson & Theca Scope, *Historical Institutionalism in Contemporary Political Science*, in POLITICAL SCIENCE: STATE OF THE DISCIPLINE 693, 693–721 (Ira Katz Nelson & Helen V. Milner eds., 2002) (describing the role of institutions in preserving historical structures).

business as a means to stimulate economic activity and social change. Part IV delineates how that feedback has been self-reinforced by small business congressional committees and the SBA, which ultimately cultivated the creation of the SBIC program. Part V establishes how the feedback and reinforcement have resulted in lock-in despite empirical evidence of dismal results by the SBIC program from its inception to the present. Our legal system remains heavily invested in an unsuccessful path, believing the costs of change outweigh any advantages from possible change. Finally, Part VI concludes that the time is ripe to break the SBIC path dependency through radical reform and to return to the initial proposal to finance small business through private local banks.

II. PATH DEPENDENCE AS REFLECTED IN A POLITY

Past decisions can affect our decisions today, even if society has changed significantly and those past circumstances may no longer be relevant.²⁵ When certain conditions are present, an inefficient policy path can become locked-in, with the cost of switching to a superior alternative becoming prohibitively high.²⁶ Economist Paul David identified four common conditions that may contribute to path dependency in an economy that faces different technological choices: increasing returns, self-reinforcement, positive feedback, and lock-in.²⁷ Increasing returns means the more a choice is made, the greater its benefits due to the fact that more people opt to make this particular choice.²⁸ Self-reinforcement describes a condition where once

25. Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332, 332–37 (1985).

26. See, e.g., Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 645–46 (1996) (arguing that the possibility of breaking out of a lock-in situation lies in the overall efficiency and strength of the pattern created in the past); Daryl Lim, *Copyright Under Siege: An Economic Analysis of the Essential Facilities Doctrine and the Compulsory Licensing of Copyrighted Works*, 17 ALB. L.J. SCI. & TECH. 481, 508 (2007) (“Consumers become ‘locked in’ to the product because of switching costs associated with moving from one network to another.”); see also Maximo Kanger, *The Rise of Managerial Judging in International Criminal Law*, 53 AM. J. COMP. L. 835, 909 n.369 (2005) (same).

27. David, *supra* note 25, at 332.

28. Paul Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94 AM. POL. SCI. REV. 251, 252 (2000). For example, the more a contract term is used by firms, the greater the benefit from the common use of standard terms. Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L. Q. 347, 348 (1996). Another example is the Polya Urn. In this experiment, there is a large urn containing two balls, one black, and one red. Each time, one ball is removed, and then returned to the urn, accompanied by an additional ball of the

a choice has been made, it creates complementary institutions that maintain this choice.²⁹ Next, positive feedback processes are positive externalities created when the same choice is made by other people, i.e., there exists a benefit to people from having their choice be the prevailing one.³⁰ Finally, the lock-in effect describes a circumstance by which an inefficient choice is repeated because a sufficient number of people have become invested in that choice.³¹ While the path dependence theory stresses that the future path depends largely on past choices, it also acknowledges that sudden shocks can alter the course of history.³²

same color. This process is repeated until the urn is full. This experiment demonstrates that early draws in each trial, although random, will have an increasing effect on the final result. See generally Greg Hill, *History, Necessity, and Rational Choice Theory*, 9 RATIONALITY & SOC'Y 189, 198–200 (1997).

29. For instance, states establish institutions in order to coordinate their actions through telecommunication institutions. Because development of those institutions is both time-consuming and resource intensive, states will be less inclined to deviate from current structures for risk of losing their existing investment. William J. Aceves, *Institutionalist Theory and International Legal Scholarship*, 12 AM. U. J. INT'L L. & POL'Y 227, 246 (1997) (citing Wayne Sandholtz, *Institutions and Collective Action: The New Telecommunications in Western Europe*, 45 WORLD POL. 242 (1993)) (discussing the role of institutions in technological and market changes).

30. For example, the more consumers use a certain software, the more applications are written to accompany this software and improve the software's features, which attracts more users to purchase this software. Marina Lao, *Reclaiming A Role For Intent Evidence In Monopolization Analysis*, 54 AM. U. L. REV. 151, 182 (2004) (describing positive feedbacks created when more users use Windows software).

31. Building on the software example in *supra* note 30, because consumers face high switching costs in changing to another software, they become "locked in" and dependent on the initial software. Daryl Lim, *Copyright Under Siege: An Economic Analysis of the Essential Facilities Doctrine and the Compulsory Licensing of Copyrighted Works*, 17 ALB. L.J. SCI. & TECH. 481, 508 (2007); see generally Scott E. Page, *Path Dependence*, 1 Q. J. OF POL. SCI. 87, 88 (2006) (identifying the processes of obtaining music performance rights for theatrical motion pictures as examples of path dependent historical processes). According to path dependence scholars, the possibility of breaking out of a lock-in situation lays in the overall efficiency and strength of the pattern created in the past. See Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 645–46 (1996); Maximo Kanger, *The Rise of Managerial Judging in International Criminal Law*, 53 AM. J. COMP. L. 835, 908 n.369 (2005).

32. Douglas J. Puffert, *Path Dependence, Network Form, and Technological Change*, in HISTORY MATTERS: ESSAYS ON ECONOMIC GROWTH, TECHNOLOGY, AND POPULATION 63, 63 (Timothy W. Guinnane, William A. Sundstrom, Warren C. Whatley eds., 2004) ("A process of economic allocation is called *path dependent* when the sequence of allocations depends not only on fundamental, *a priori* determinants—typically listed as technology, factor endowments, preferences, and institutions—but also on particular contingent events.").

When applying these common conditions of path dependency to politics,³³ political scientist Paul Pierson noted that four aspects of the political realm reinforce increasing returns processes: (1) the central role of political collective action; that is, the effectiveness of one's political action, depends heavily on the actions of others and requires positive feedback to provide confidence that a large number of other people will do the same; (2) the high density of institutions encourages social actors to make commitments causing their cost of exit from established arrangements to rise dramatically; (3) power asymmetry in politics allows certain actors that are in a position to impose rules on others to make open political conflict unnecessary; and (4) the fact that the political system is usually complex and murky induces increasing returns in an attempt to make social interpretations of the current political system.³⁴

Pierson concludes that path dependence in politics puts organizations in the center and says “despite massive social, economic, and political changes over time, self-reinforcing dynamics associated with collective action processes mean that organizations have a strong tendency to persist once they are institutionalized.”³⁵ Explicitly, political institutions have a great influence in reinforcing path dependence in our society by sustaining dynamics of “increasing returns” through “self-reinforcement” and “positive feedback” processes in a political system.³⁶

Nobel Prize winning economist Douglass North emphasized the role of path dependence in explaining patterns of institutional emergence,

33. One example of increasing returns dynamics in a polity is the persistence of government structures of ancient European settlements. In remote and unattractive areas, colonists tended to create colonies lacking strong property protections and safeguards against government expropriation, while in areas with more welcoming climates, Europeans were more inclined to establish colonies with more representative governance structures and trade-friendly policies. These initial institutional arrangements persisted as those colonies developed political structures and reinforced their paths. Daron Acemoglu, Simon Johnson, & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369, 1373–77, 1395 (2001).

34. Pierson, *supra* note 28, at 257–62.

35. *Id.* at 258–59.

36. *Id.* at 251; Paul Pierson & Theda Skocpol, *Historical Institutionalism in Contemporary Political Science*, in POLITICAL SCIENCE: THE STATE OF THE DISCIPLINE 693, 699–703 (Ira Katznelson & Helen V. Milner eds., 2002). Pierson noted that what economists call “increasing returns” could generally describe self-reinforcing or positive feedback processes when analyzed against the distinctive characteristics of social processes. Pierson, *supra* note 28, at 251. Pierson also noted “for some theorists, increasing returns are the source of path dependence, for others, they typify only one form of path dependence.” *Id.*

persistence, and change.³⁷ He asserted it is important to distinguish between organizations and institutions, because while both provide the structural framework supporting human discourse, institutions are considered the rules of the game that contain constraints and enforcement characteristics, whereas organizations are the players.³⁸ Organizations usually exercise their influence to maintain themselves and to stifle upstarts and change.³⁹ This is even more pronounced when they also serve as agents of certain groups in society, and thus are not obligated to the general good of all citizens but only to the ones they represent.⁴⁰ Once in place, institutions are hard to change, and they have a tremendous effect on the possibilities for generating sustained economic growth.⁴¹

Consequently, even if superior choices become available down the road, the entrenchment of certain institutional arrangements obstructs further change or any chance to reverse the initial choice.⁴² Moreover, alternatives

37. Douglass C. North, *The Historical Evolution of Politics*, 14 INT'L REV. L. & ECON. 381, 385 (1994); see generally DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 92–104 (1990) (considering the structure of institutions and their impact on the organizations that operate according to them).

38. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE, *supra* note 37, at 4–5.

39. *Id.* at 5.

40. *Id.* at 100. See, also Pierson, *supra* note 28, at 259 (“[D]espite massive social, economic, and political changes over time, self-reinforcing dynamics associated with collective action processes mean that organizations have a strong tendency to persist once they are institutionalized.”).

41. See, e.g., William J. Aceves, *Institutionalist Theory and International Legal Scholarship*, 12 AM. U. J. INT'L L. & POL'Y 227, 246–47 (1997) (observing how legal, market, and technological changes can be transformed by states into institutions). See also, Douglas J. Puffert, *Path Dependence, Network Form, and Technological Change*, in HISTORY MATTERS: ESSAYS ON ECONOMIC GROWTH, TECHNOLOGY, AND POPULATION 63, 63 (Timothy W. Guinnane, William A. Sundstrom, Warren C. Whatley eds., 2004) (“A process of economic allocation is called *path dependent* when the sequence of allocations depends not only on fundamental, *a priori* determinants—typically listed as technology, factor endowments, preferences, and institutions—but also on particular contingent events.”) (emphasis added); see also RICHARD R. NELSON & SIDNEY G. WINTER, AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE (1982) (discussing path dependence and evolutionary economics processes); Scott E. Page, *Path Dependence*, 1 Q. J. OF POL. SCI. 87, 88 (2006) (applying path dependency theory to the process of obtaining music performance rights for theatrical motion pictures). David's conception of path dependency concerns economic and technological developments, but has been extended to institutions. See *supra* note 25.

42. See, e.g., Margaret Levi, *A Model, a Method, and a Map: Rational Choice in Comparative and Historical Analysis*, in COMPARATIVE POLITICS: RATIONALITY, CULTURE, AND STRUCTURE 17, 19–41 (Mark I. Lichgate & Alan S. Zuckerman eds., 1997) (using the metaphor of a tree where, “from the same trunk, there are many different branches and smaller

that were once plausible may become inefficient to recover further down the road. In this way legal and political institutions can interfere with the natural progress of development and change, and may render an unwelcome path determined result.

III. POSITIVE SMALL BUSINESS FEEDBACK

Culture influences institutional performance. Yet, culture is a broad term that includes, but is not limited to, values, ideas, beliefs and other symbolic, meaningful systems that shape human behavior.⁴³ It affects how we interpret and process information, how we act, and how we expect others to act.⁴⁴ Small business culture originated from Americans' increasingly romantic and protective feelings about small businesses. Americans have long held dear general values of freedom and decentralization, and these values are reflected in the culture's positive feelings toward small businesses. Small Business enterprises, Americans believe, epitomize individuality and freedom, and are a counterpoint to large corporations. Although not necessarily true, small business have been portrayed as entrepreneurs and as contributing greatly to economic development.⁴⁵ This association of small businesses with fundamental American values reinforced policies favoring small businesses.

The fundamental importance of small business, grounded in our culture, supported the persistence of small business programs such as the SBIC. Small business culture produced a build-up of behavioral routines, social connections, and cognitive structures that provided "positive feedback" to the government of the positive externalities small business create in society

branches. Although it is possible to turn around or to clamber from one to the other-and essential if the chosen branch dies, the branch on which a climber begins is the one she tends to follow.").

43. Geert Hofstede, *Culture and Organizations*, 10 INT'L STUD. MGMT. & ORG., 15, 15-18 (1981).

44. See, e.g., Jenna Bednar & Scott E. Page, UNIVERSITY OF MICHIGAN INSTITUTE OF GOVERNMENTAL STUDIES, *Culture, Institutional Performance, and Path Dependence*, at 1 (2005), <http://www.cscs.umich.edu/~spage/instpath.pdf>.

45. See, e.g., 133 Cong. Rec. S6599 (Daily ed. May 15, 1987) (Statement of Sen. Karnes) ("The true entrepreneurial spirit thrives in small business throughout this country . . . much of the future of America's economy depends on the ideas of our entrepreneurs in small business."). But see, Martin A., *New Research Weakens Case for Small Business Tax Relief*, 134 Tax Notes 54 (Jan. 3, 2012), <http://www.tax.com/taxcom/taxblog.nsf/Permalink/UBEN-8Q7JUU?OpenDocument> ("Small businesses are mainly skilled craftspeople...[that] do little innovation. They provide relatively standardized goods and services for existing customer bases.")

that would seemingly disappear if the path were altered. Keepers of free competition,⁴⁶ indicators to a healthy economy,⁴⁷ and promoters of minorities and social justice⁴⁸ were some of the positive feedback attributable to small concerns. Congressional interest in the small business programs over time has increased due to that positive feedback that viewed the program as another means to stimulate economic and social change.⁴⁹ Mistrust of big corporations and the belief in free enterprise were other social values instrumental in reinforcing the path.⁵⁰ Along with those dynamics of positive feedback, small business organizations provided effective reinforcement that together contributed to the persistence of small business programs.⁵¹

Originating from values of freedom and dispersion of power, a set of beliefs was formed about the benefits small businesses generate. Their volatile condition in times of economic crises and natural disasters nurtured the path of small business favoritism. This type of solicitude toward small business at times became a bias, not always justified on its merits.⁵² Congress sought to protect independent small businesses from the power of trusts, crime, recessions, natural disasters, discrimination, poverty, heavy red tape and compliance costs. As America weathered internal economic crises, external natural catastrophes and changes in social status of minorities, these important events in twentieth century history sustained the path of small business favoritism.

46. *See infra* Part III.A.

47. *See infra* Part III.C.

48. *See infra* Part III.D.

49. *See, e.g.*, Robert Jay Dilger & Oscar R. Gonzales, *Small Business Investment Company Program*, CONG. RESEARCH SERV. 1 (June 23, 2011), <http://www.ndia.org/Divisions/Divisions/SmallBusiness/Documents/SBA%20Small%20Business%20Investment%20Company%20Program.pdf>.

50. Richard J. Pierce, Jr., *Small is Not Beautiful: the Case against Special Regulatory Treatment of Small Firm*, 50 ADMIN. L. REV. 537, 542 (1998) (noting that the myth that small is good and big is bad that is deeply rooted in our cultural beliefs is responsible for that phenomenon).

51. *Id.*

52. *See generally* Mirit Eyal-Cohen, *Down-sizing the "Little Guy" Myth in Legal Definitions*, 98 IOWA L. REV. (forthcoming 2013).

A. *Small Business as the Epitome of American Liberty*

America has a love-hate relationship with big business.⁵³ While big businesses are associated with efficiency in production and are credited with raising the standard of living, they are feared for the power they possess over prices, wages and social values.⁵⁴ On the other hand, the public and small businesses have had a long, continuous love affair. It started with the writers of the Constitution creating checks and balances against concentration of political power. It continued with the widely accepted proposition that one prerequisite for a good society and a prosperous economy is numerous small businesses.⁵⁵

American culture celebrates liberty and shuns concentrations of power.⁵⁶ Inherited from British common law, a suspicion of corporate charters was witnessed by the founding father's view that such special privileges generally led to monopoly.⁵⁷ Similarly, the choice of a federalist system reflected a mixture of reliance on and mistrust in a centralized authority, and resulted in a Constitution that created a federal government with checks and balances.⁵⁸

Until the end of the nineteenth century, small businesses were the norm—most businesses were modest and had relatively local dealings.⁵⁹ They played an important role in developing the nation's economy as thousands of small firms handled the production and distribution of goods

53. See, e.g., MANSEL G. BLACKFORD, *A HISTORY OF SMALL BUSINESS IN AMERICA* 47 (2d ed. 2003) (describing public attitudes and government policies toward small and big business).

54. *Id.*

55. See, e.g., PARRIS, *supra* note 10, at vi. (“The fear of centralization has recurred throughout our history, and there has long been a suspicion among many Americans that economic power is political power. Hence, there have always been voices inveighing against interests and championing diffusion . . . Sprung from the theories of the Founding Fathers, this conviction remains a basic American principle.”).

56. THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776) (“[A]ll men are . . . endowed . . . with certain unalienable Rights, that among these are Life, Liberty, and the pursuit of Happiness.”); see also G. WOOD, *THE CREATION OF THE AMERICAN REPUBLIC, 1776–1787* viii (1969) (discussing the concepts of “liberty,” “virtue,” and “republicanism” in that period).

57. Daniel A. Crane, *Antitrust Antifederalism*, 96 CALIF. L. REV. 1, 6 (2008).

58. “From the start, Americans have regarded their government with a mixture of reliance and mistrust ‘If men were angels,’ observed the 51st Federalist Paper, ‘no government would be necessary.’” CHRISTOPHER DWYER, *THE SMALL BUSINESS ADMINISTRATION (KNOW YOUR GOVERNMENT)* 7 (1991) (citing ARTHUR M. SCHLESINGER, JR., *THE CRISIS OF CONFIDENCE: IDEAS, POWER, AND VIOLENCE IN AMERICA* (1969)).

59. See BLACKFORD, *supra* note 53, at 11 (“[T]housands of small, personally owned and operated firms . . . formed the glue of America’s business system.”).

and services.⁶⁰ With the advancement of technology that permitted economies of scale and scope came the “transportation revolution” by which big firms emerged and began to dominate the production industry, specifically railroads.⁶¹ Big businesses soon developed into giant trusts by vertically integrating enterprises to combine mass production with mass distribution, and controlled all the production and sale stages of their products. Small firms survived this age of giants by occupying market niches ignored by big businesses.⁶²

Concern for small business remained at the heart of American society.⁶³ The very nature of the nation's democracy, said Lawrence M. Friedman, is “small local people, with small, local minds, wield[ing] enormous power over schools and over municipal politics.”⁶⁴ The national ethos of the “American dream” and “the land of endless opportunity” have been irrevocably entwined with preserving free private enterprise and the need to guarantee the well-being of small business.⁶⁵ Yet, to protect small business interests, the government had to regulate the market and limit the freedom of some market actors, sometimes restricting the same economic freedom it sought to promote.⁶⁶ Over the years, antitrust laws and trade regulations were some of the measures taken to regulate abuses of corporate power. This type of restrained capitalism has been the subject of much debate and its boundaries are still being reexamined today.⁶⁷

60. *Id.*

61. TAMIR AGMON & RICHARD DROBNICK, *SMALL FIRMS IN GLOBAL COMPETITION* 9–10 (1994).

62. BLACKFORD, *supra* note 53, at 11–14; *see also* Sanford L. Jacobs, *Small Business: Small Concerns Find a Niche Solving Problems of Big Firms*, *WALL ST. J.*, Apr. 21, 1986, at 25 (arguing small concerns find segments of the market big companies are not serving).

63. *See, e.g.*, David Broiles, *When Myths Collide: An Analysis of Conflicting U.S.-Japanese Views on Economics, Law, and Values*, 1 *TEX. WESLEYAN L. REV.* 109 (1994) (comparing the differences between the American and the Japanese conceptions of fair competition and belief in government intervention in the market economy).

64. Lawrence M. Friedman, *Access to Justice: Some Comments*, 73 *FORDHAM L. REV.* 927, 930 (2004).

65. *See, e.g.*, 124 *CONG. REC.* 5433 (1978) (statement of Rep. Hamilton (D-IN)) (“[T]he independent entrepreneur is a central figure in American folklore—an integral part of the ‘American Dream.’”).

66. For the expansion of federal jurisdiction attributable to protecting business interests *see, e.g.*, FELIX FRANKFURTER & JAMES M. LANDIS, *THE BUSINESS OF THE SUPREME COURT: A STUDY IN THE FEDERAL JUDICIAL SYSTEM* 64–65 (1928).

67. Critics often claim that the government became too involved in business. For a description of the change in the model of corporate regulation *see, e.g.*, Susan J. Stable, *Using Religion to Promote Corporate Responsibility*, 39 *WAKE FOREST L. REV.* 839, 872 (2004).

B. Small Business Culture in Light of Endogenous Crises

Over the years, internal predicaments within the market affected Congress's sense of responsibility to the well-being of small business. Merger waves, hostile takeovers and other anti-competitive dealings originating within the market had a large effect on strengthening small business culture. Although Congress could not prevent anti-competitive conduct altogether, it felt responsible for the effect that conduct had on small business. Congress responded by trying to regulate large business while increasing small business favoritism.⁶⁸

In the 1800s, monopolies were a key feature of the U.S. economy, which eventually spurred lawmakers to enact antitrust legislation. In the age of giant railroads, oil, steel, and sugar trusts, companies such as U.S. Steel and Standard Oil controlled the supply and prices of products in their industries. To protect competition in the "movement of commerce," that is, the transportation industry,⁶⁹ Congress enacted the Interstate Commerce Act in 1887.⁷⁰ Three years later, Congress broadened competition policy by passing the Sherman Act "to protect trade and commerce against unlawful restraints and monopolies."⁷¹ It also created the Federal Trade Commission as an independent regulatory agency and empowered it to assist the Justice Department in enforcing antitrust laws.⁷² During the Gilded Age, monopolies and trusts were formed.⁷³ In response, the government enacted antitrust laws that sought to balance and regulate, yet not destroy, concentrations of economic power.⁷⁴ Congress sought to maintain a free market by supporting

68. *Mergers Still Threaten Small Business, Says House Panel's Report*, WALL ST. J., Nov. 9, 1962, at 3.

69. Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 32 (1966).

70. Ch. 104, 24 Stat. 379 (1887) (codified as amended in scattered sections of 49 U.S.C.).

71. Ch. 647, 26 Stat. 209 (1890) (codified as 15 U.S.C.S §§ 1-7).

72. Federal Trade Commission Act of 1914, ch. 311, 38 Stat. 717 (codified as amended at 15 U.S.C. §§ 41-58 (2010)).

73. *See generally* MARK TWAIN & CHARLES DUDLEY WARNER, *THE GILDED AGE: A TALE OF TODAY* (1873).

74. Soon after its enactment, the Sherman Act was weakened by courts as they interpreted its ambiguous terms narrowly. *See* Rudolph J. Peritz, *The "Rule of Reason" in Antitrust Law: Property Logic in Restraint of Competition*, 40 HASTINGS L.J. 285, 287 (1989) (describing the Supreme Court's struggle with the Sherman Act and its adoption of a "literalist" approach). Consequently, Congress proceeded with amending the Sherman Act and followed by passing other antitrust laws to reinforce it. *See* Clayton Act of 1914, ch. 323, 38 Stat. 730 (codified 15 U.S.C.S §§ 12-27, 44; 29 U.S.C.S § 52); Robinson-Patman Act of

small firms. Small firms became a symbol of fair competition,⁷⁵ free flow of ideas, and freedom to pursue a new venture.⁷⁶ Thereafter, preconceptions of the role of government as protector of competition followed this era and reinforced the path of small business favoritism.⁷⁷ Great merger waves during 1895–1905, 1925–29, 1965–68, and the early 1980s renewed debate over the extent of government intervention necessary to maintain free competition.⁷⁸

During those waves, Congress was reluctant to limit conglomerates and interfere in market forces too greatly. Therefore, Congress assumed the role of guardian of small firms. Instead of directly restricting large firms, it sought indirectly to help small business compete with its counterparts. To reduce the incentives for big businesses to merge, Congress eliminated

1936, ch. 592, 49 Stat. 1526 (codified 15 U.S.C.S §§ 13, 13a, 13b, 21a); Miller-Tydings Fair Trade Act of 1937, ch. 690, title VIII, 50 Stat. 693 (codified 15 U.S.C.S § 1); District of Columbia Revenue Act of 1937, ch. 690, 50 Stat. 673; Sherman Antitrust Act, ch. 281, 69 Stat. 282 (1955); Consumer Goods Pricing Act of 1975, Pub. L. No. 94–145, 89 Stat. 801; Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94–435, 90 Stat. 1383; Export Trading Act of 1982, Pub. L. No. 97–290, 96 Stat. 1233; Antitrust Amendments Act of 1990, Pub. L. No. 101–588, 104 Stat. 2879.

75. See, e.g., 97 CONG. REC. 6773 (1951) (statement of Rep. Abraham J. Multer (D., NY)) (discussing the Robinson-Patman Act, Rep. Multer stated, “Competition is healthy. But unfair, cutthroat competition has the effect of destroying competition by forcing independents out of business and leaving the field clear for monopoly.”). See also STAFF OF S. SELECT COMM. ON SMALL BUS., SUBCOMM. ON MONOPOLY, REPORT TO THE FEDERAL TRADE COMMISSION: MONOPOLISTIC PRACTICES AND SMALL BUSINESS, 82-2 CIS-NO: S5250 (1952); 128 CONG. REC. 9177 (1982) (statement of Rep. Samuel Augustus Nunn, Jr. (“I have briefly reviewed these statistics to demonstrate that small business is not a special interest group in our American economy. Small business is the heart of the free enterprise system, that sector most likely to take the steps necessary to get this Nation back of the road to economic recovery.”)).

76. See 103 Cong. Rec. 10, 208 (1957) (statement of Rep. Paul Brown) (“Small business is a symbol of opportunity, enterprise, innovation, and achievement. It is an independent way of life, standing for something quite essential to our freedom.”).

77. See Allen D. Boyer, *Activist Shareholders, Corporate Directors, and Institutional Investment: Some Lessons from the Robber Barons*, 50 WASH. & LEE L. REV. 977, 992 (1993).

78. Harvard economics professor Andrei Shleifer and University of Chicago finance professor Robert W. Vishny claim four major merger waves occurred in the twentieth century. Andrei Shleifer & Robert W. Vishny, *The Takeover Wave of The 1980s*, 249 SCIENCE 745 (1990). The first one came as a reaction to the Sherman Antitrust Act in 1890, and ended in the beginning of the twentieth century with several Supreme Court decisions and the Clayton Act. *Id.* at 745. The second merger wave began in late 1920, coinciding with a buoyant stock market, and ended in the Great Depression. *Id.* at 745. The third wave came in the late 1960s, when conglomerate mergers were initiated in a stock market boom. *Id.* at 745. The last one was the takeover wave of the 1980s, which was characterized by a great number of hostile takeovers. *Id.* at 746.

benefits associated with mergers and takeovers.⁷⁹ Congress also increased the lending authority of small business organizations as a way to enable small businesses to resist mergers or acquisitions and tripled the damages in antitrust claims against large companies.⁸⁰

Although trends in antitrust regulation and enforcement changed over the decades, small business, as a symbol of free enterprise, remained an unwavering element of business culture.⁸¹ For a brief period during the 1980s, small businesses lost their special status in the eyes of the

79. See Louis M. Kohlmeier, *Antitrust Offensive*, WALL ST. J., Mar. 25, 1969, at 1 (“Already the House Ways and Means Committee is considering a measure to limit the tax benefits to conglomerates that issue debentures in exchange for stock of a company being acquired.”).

80. Section 4 of the Clayton Act permits any person injured as a result of an antitrust violation to sue and recover triple the damages sustained. 15 U.S.C. § 15 (1976 & Supp. V 1981).

81. Small business favoritism through antitrust was interrupted during the merger wave of the 1980s and the laissez-faire macroeconomic policies of the Reagan administration that can be summed up as “bigness doesn’t necessarily mean badness.” Reagan’s new agenda sought to deregulate and relax antitrust enforcement efforts against large businesses in the name of efficiency. The Reagan administration, which contained many supporters of the “Chicago School” of economics, contended that antitrust law overprotects inefficient small businesses. See generally SEAN WILENTZ, *THE AGE OF REAGAN: A HISTORY 1974–2008* (2009); JOHN EHRMAN, *THE EIGHTIES: AMERICA IN THE AGE OF REAGAN* (2008); Robert E. Taylor & Stan Crock, *Giant Steps*, WALL ST. J., July 8, 1981, at 1 (quoting Reagan’s new Attorney General William French Smith who attacked past enforcement of antitrust laws as “misguided and mistaken . . . efficient firms shouldn’t be hobbled under the guise of antitrust enforcement”). Conservatives who opposed government interference in the economy such as Robert H. Bork, an antitrust law professor and author of *THE ANTITRUST PARADOX* (1978), advocated the adoption of a “consumer welfare” approach, that is the maximization of direct and immediate welfare of the consumers of a certain product. See also Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 32 (1966) (arguing the courts need to distinguish between agreements or activities that increase wealth through efficiency and those that decrease it through restriction of output); Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1021 (1987). But see James Bovard, *Soaring Succor for Select Businesses*, WALL ST. J., Feb. 1, 1984, at 24 (“When Mr. Reagan first took office, administration officials spoke of abolishing export subsidies, slashing agricultural supports and leaving the private sector to its own devices. But this administration has given more aid to business than any other administration in history.”). The Reagan administration was able to veer off in an opposite direction, and bigness was no longer a symbol of villainy but of promising prosperity. Yet, even this temporary halt in the path of small business preferences did not have a long-term effect on small businesses preferential status. It was not long before small business culture regained its standing in the eyes of the government, viewing small business owners as the gatekeepers of free competition. *Id.*

administration,⁸² while big companies were portrayed as victims and unreasonably prosecuted under antitrust laws.⁸³ In his efforts to balance the budget and close the nation's deficit, Reagan suggested cutting federal borrowing, including the SBA's loan program.⁸⁴ Reagan went as far as proposing to abolish the SBA by eradicating its loan programs and placing some of its remaining functions in the Commerce Department.⁸⁵

Nevertheless, this temporary halt in largesse toward small businesses did not have a long-term effect on their preferential status. Strong support from small business committees and Democrats hindered Reagan's efforts to eradicate the SBA and ultimately lead to an increase in the SBA's lending authority.⁸⁶ It was not long before small business culture was resurgent, and the government again viewed small business owners as the gatekeepers of free competition.

82. At some point, Reagan's policies even started to harm small business. For example, the antitrust division in the Reagan administration did not actively prosecute many antitrust cases. See Taylor & Crock, *supra* note 81, at 1 ("Cases didn't get filed on the basis of Populist ideas of economic pluralism," says Mr. Shenefield, the former antitrust chief."). In another case, government officials testified at a hearing of the House Monopolies Subcommittee in favor of certain mergers of large financial-services companies. *Big Financial-Services Mergers Don't Hurt Competition or Consumers*, U.S. Aides Say, WALL ST. J., July 9, 1981, at 6.

83. Taylor & Crock, *supra* note 81, at 1 ("[A] bill to give surer antitrust exemptions to companies that combined forces on export business.").

84. Laurie McGinley, *Treasury Borrowing Needs Are Projected At \$203 Billion New Cash In Fiscal Year 1984*, WALL ST. J., Jan. 31, 1983, at 5 ("Under the administration's proposal, the Small Business Administration's subsidized direct-loan program would end, as would the mortgage-purchase activities by the Government National Mortgage Association.").

85. See Deficit Reduction Act of 1984, H.R. 4170, 98th Cong., 98 Stat. 1057 (1984); Consolidated Omnibus Budget Reconciliation Act of 1985, H.R. 3128, 99th Cong., 100 Stat. 82, 99 (1986); *Administration's Budget Proposal for the SBA for Fiscal Year 1988: Hearing before S. Comm. on Small Bus.*, 100th Cong. 100-32 (1987); Robert W. Merry, *Reagan Strategy Aims to Slash Programs and Not Just Dollars*, WALL ST. J., Feb. 4, 1985, at 4; *Plan to Eliminate SBA As Agency Proposed Again*, WALL ST. J., Feb. 6, 1986. When his efforts were fruitless, Reagan went as far as nominating a new SBA administrator to execute his plans to abolish SBA loans through the back-door. See Albert R. Karr, *SBA Head Fires Five Regional Chiefs Who Oppose Plan To Close Down Agency*, WALL ST. J., Apr. 2, 1986, at 20; Steven P. Galante, *Reagan To Name Sen. Abdnor SBA Head, Signaling End to Effort To Close Agency*, WALL ST. J., Dec. 24, 1986, at 23.

86. See, e.g., Peter Rodino, *Fearing Effects of Large Mergers, Plans House Hearings on Antitrust Policy*, WALL ST. J., July 23, 1981, at 21 (House Judiciary Committee Chairman Peter Rodino (D-NJ) questioning whether small businesses could survive in an economy in which all economic assets were concentrated in a few large corporations); Tim Carrington, *Raiding Republican Turf*, WALL ST. J., May 15, 1984, at 62 (Democrats woo small business); *Senate Committee Insists That It Has Votes To Save SBA*, WALL ST. J., Mar. 1, 1985, at 6; *Senate Business Panel Backs Funding of SBA*, WALL ST. J., Mar. 27, 1985, at 23.

C. *Small Business Culture in Light of Exogenous Crises*

Small business's failure to acclimate to extrinsic, apolitical forces was viewed by the government over the decades as a national problem. The government felt particularly responsible for the condition of small businesses and at times culpable for the woes they experienced. A historical sequence of extreme events that originated outside the socio-economic system, such as hurricanes, earthquakes, and floods, had a large effect on the expansion of small business favoritism. Consequently, the government used its power to regulate the market and to grant small business temporary relief that became permanent even when the threat had passed.

In his book *Crisis and Leviathan*, Robert Higgs argues that the main reason for the expansion of government lies in its responses to crises such as economic turmoil, natural disasters and war.⁸⁷ The extension of government emergency power, according to Higgs, endures long after each crisis has passed, encroaching on civil and economic liberties and fostering extensive corporate welfare.⁸⁸ As the government's power grows, writes Higgs, it becomes autonomic and maintains its size and scope.⁸⁹ Aside from the expansion of government, economic shocks, such as the recent economic downturn, also generate benefits to certain groups that persist even after the crisis is resolved.⁹⁰

Seen as a particularly vulnerable part of the production chain, small business favoritism has expanded during crises. For example, on March 27, 1964, a forceful earthquake struck Alaska followed by seismic waves devastating much of Anchorage and many seacoast towns.⁹¹ Although there were no casualties, the impact of the quake was serious.⁹² That same year, a series of six Atlantic hurricanes killed over 200 civilians and caused an estimated at \$2.5 billion in property damage in Florida, Louisiana, Texas, Georgia, and North Carolina.⁹³ Floods in Montana and the Ohio River

87. ROBERT HIGGS, *CRISIS AND LEVIATHAN* 17 (1989).

88. *Id.* at 11.

89. *Id.* at 189.

90. *Id.* at 168.

91. MANSEL G. BLACKFORD, *PIONEERING A MODERN SMALL BUSINESS: WAKEFIELD SEAFOODS AND THE ALASKAN FRONTIER* 92 (1979).

92. *Id.*

93. On the economic effect of these hurricanes, see Arnold L. Sugg, *Economic Aspects of Hurricanes*, *MONTHLY WEATHER REV.* 143 (1967), available at <http://www.bama.ua.edu/~jcsenkbeil/gy4570/sugg%201967%20economic.pdf>.

Valley, forest fires in California, and a big cloudburst in Arizona were other natural catastrophes that year.⁹⁴

As an immediate response to these catastrophes, the government enlarged lending to small business. Congress authorized the SBA to make immediate disaster loans totaling about \$49.5 million.⁹⁵ Consequently, the SBA curtailed its regular small business loan program to preserve money for disaster lending.⁹⁶ In September 1964, President Johnson asked Congress to bail out the SBA with a \$60 million supplemental appropriation to its depleted reserves in the wake of the hurricanes, earthquakes and floods.⁹⁷

Yet, these allowances, which were created to support small firms in a time of emergency, remained in place after the danger had passed. Two years after the Alaska calamity, Congress voted to continue to divert money to meet heavy demand for SBA disaster loans.⁹⁸ Started as a temporary solution to an immediate problem, the SBA disaster assistance programs became permanent and remain operative to this day. Over the years, the loan program was expanded to offer low interest loans to homeowners, renters, non-profit organizations, and businesses of all sizes.⁹⁹ Much like the 1960s disasters, the same pattern of government response can be seen in recent disasters, including the Deepwater Horizon oil spill.¹⁰⁰

Lastly, due to their increased risk of failure, small businesses have constantly faced tight credit and difficulties in securing capital or borrowing

94. See generally E. L. Quarantelli & Russell R. Dynes, *Response to Social Crisis and Disaster*, 3 ANN. REV. SOC. 23 (1977); THEODORE STEINBERG, *ACTS OF GOD: THE UNNATURAL HISTORY OF NATURAL DISASTER IN AMERICA* 41-47 (2006).

95. *Small Business Agency Curbs Loans to Firms: Cites Disaster Lending*, WALL ST. J., Nov. 10, 1964, at 3.

96. *Id.* The unusual number of disasters reduced its revolving funds “to the point where conservation measures are required.” *Id.*

97. *Johnson Requests \$60 Million to Replenish the Small Business Administration’s Loan Fund*, WALL ST. J., Sept. 24, 1964, at 12.

98. The legislation also created two revolving funds, one for the physical disaster program and one for SBA’s regular projects. See *Small Business Agency’s Loan Limit and Funds Increased by Senate*, WALL ST. J., Mar. 9, 1966, at 5.

99. SBA DISASTER ASSISTANCE, <http://www.sba.gov/services/disasterassistance> (last visited Jan. 13, 2012).

100. As a response to the Deepwater Horizon oil spill, the government approved an increase to the SBA lending authority. The SBA approved 128 economic injury assistance loans, totaling more than \$8.5 million, for small businesses in the Gulf Coast affected by the spill. Additionally, the agency granted deferments on 531 existing SBA disaster loans in the region, totaling more than \$2.6 million per month in payments. See Heidi Avery, *The Ongoing Administration-Wide Response to the Deepwater BP Oil Spill: June 30, 2010*, THE WHITE HOUSE BLOG (July 1, 2010, 10:15 AM), <http://www.whitehouse.gov>.

loans.¹⁰¹ Therefore, the equity gap between small business demand for outside sources of funding and the supply of capital or loans to these firms is often wide.¹⁰² Congress, through various small business programs, tried to mitigate the effects of this constant equity gap of small business funding. For example, at certain times, the government allowed banks to charge more interest over the prime on its SBA loans that were 90% guaranteed by the government to encourage banks that were increasingly hesitant to lend on such terms, even when the government assumed most of the risk.¹⁰³ And although the supply of credit to small business is strongly correlated to the inherent risk premium small business possesses, the government continuously tried to “repair” the credit market and mitigate the effect of the equity gap on small businesses.

Likewise, recessions are another type of event over which Congress had little control. But lawmakers, nevertheless, have attempted to address the effect of recessions on the economy. Since small businesses often have tiny reserves, they can be deeply affected by recessions. Such was true in the recessions at the beginning of the 1970s and the 1980s.¹⁰⁴ High inflation, which added to debts, had an especially devastating effect on small businesses, which had perennial difficulty in obtaining capital in the first place.¹⁰⁵ Between 1973-1975 and 1980-1982, recessions forced many businesses to close and many people lost their jobs.¹⁰⁶ Tight credit

101. See generally Richard J. Judd & Barbra K. Sanders, *Regulation, Small Business, and Economic Development: A Historical Perspective on Regulation of Business*, in POLICY STUDIES ORGANIZATION, *SMALL BUSINESS IN A REGULATED ECONOMY: ISSUES AND POLICY IMPLICATIONS* 223 (Richard J. Judd et al. eds., 1988).

102. *Id.* See also John A. Prestbo, *Going it Alone: More Individuals Buck Alarming Rate To Start Own Firms*, WALL ST. J., Apr. 10, 1969, at 1 (“Many banks shun new business loans as too risky even when money is not tight . . .”).

103. Yet, when business failures continued to soar, small businesses blamed the SBA for not addressing the problem properly. Sanford L. Jacobs, *SBA’s Plan to Cut Loan Rates Generates Lots of Opposition*, WALL ST. J., Oct. 26, 1981, at 29.

104. Recessions in the 1980s caused more than 5,550 small businesses to go under, 14% above the rate of the recession during the early 1970s. See Amal Nag, *Slump Devastates Small Businesses; Failures Threaten to Slow Recovery*, WALL ST. J., Oct. 10, 1980, at 27 (“We are seeing a fairly unique situation that is hurting small businesses worse than any previous recession . . .”).

105. See Sanford L. Jacobs, *Survival When Business is Bad Requires a Plan, Lots of Cuts*, WALL ST. J., Apr. 5, 1982, at 25.

106. Lack of credit and high interest rates contributed to business failures in the 1980s. See Sanford L. Jacobs, *Steep Borrowing Costs Tied to Prime Rate Make Going Tough for Small Businesses*, WALL ST. J., Feb. 22, 1980, at 19 (“‘I’m sick. I’m just sick,’ the 58-year-old entrepreneur says. ‘I’m worried more and more as I go along. This interest rate is too much . . .’ [H]igh interest rates ‘are the greatest contributor to current business failures.’”).

aggravated small business' failures.¹⁰⁷ In the midst of those recessions, lawmakers and presidents provided increased benefits to small firms and granted the SBA greater lending authority¹⁰⁸ to fight unemployment, recession, and other economic ills.¹⁰⁹

Economic recovery and stimulus acts were part of the artillery used to fight economic crises.¹¹⁰ Once created, that path of small business assistance often remains unchanged.¹¹¹ To address the problem of tight credit, the

107. Representative Virginia Smith (R., NE) spoke on the floor during National Small Business Week, commenting "During these difficult economic times, the spirit of small business has been tested..." 128 CONG. REC. 9572 (1982). See Thomas Petzinger, Jr., *Closed Doors*, WALL ST. J., Jan. 22, 1980, at 1.

108. For example, during the 1960s the government approved many expansions of the SBA loan program to address the tight credit problem of small firms. *Small Business Agency Loan Ceiling Increase is Approved by House*, WALL ST. J., July 3, 1962, at 3; *House Unit Votes to Raise SBA's Ceiling on Loans*, WALL ST. J., Jan. 8, 1962, at 26; *Small Business Agency Loan Ceiling Raised \$250 Million by Senate*, WALL ST. J., June 15, 1962, at 14. *Higher SBA Loan Limit Backed by Senate Panel*, WALL ST. J., Sept. 17, 1980, at 3.

109. *Kennedy Readies Program to Curb Jobless Roll Rise*, WALL ST. J., Nov. 21, 1960, at 3 (announcing that more loans will be granted to small business concerns at interest rates lower than the current rates charged by the SBA to help provide additional jobs). See also *Small Business Agency Cuts Interest Loans in 101 Distressed Area*, WALL ST. J., Apr. 6, 1961, at 3. See, also, *Credit Crunch, Year-End Recession Loom, Democrats of Joint Economic Panel Warn*, WALL ST. J., Mar. 26, 1973, at 4; Jerry Landauer, *Democrats' Slowness in Paying Their Bills Irks Small Businesses*, WALL ST. J., Feb. 5, 1980, at 1. ("When President Carter, in the midst of his Iranian and Afghanistan troubles, took time out to address 2,000 representatives of small business last month, it was considered a powerful testament to the political importance of the group But . . . [a]s far as they're [Small Businesses] concerned, the President could start by getting the Democratic Party to honor its debts."); Sanford L. Jacobs, *Updates on Some 1982 Stories of Interest to Small Concerns*, WALL ST. J., Jan 3, 1983, at 25.

110. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172. In this act, Congress created the "Accelerated Cost Recovery System" (ACRS), and liberalized the depreciation rules by changing the recovery period of certain assets retroactively. Although this measure was presented as a small-business aid, it did not provide aid to concerns that did not have enough new assets put into service or enough profits to offset against those deductions. Eventually, those rules resulted in some small firms trading their depreciation benefits with their larger counterparts. 128 CONG. REC. 9177 (1982). See also Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085; Sanford L. Jacobs, *How Changes in the Tax Law Will Affect Small Companies*, WALL ST. J., Oct. 19, 1981, at 31.

111. See *Tax Report*, WALL ST. J., Jan. 4, 1961, at 1 (reporting that members of the House Ways and Means committee sponsored a bill that gave further tax relief to small business by providing additional depreciation deductions while expanding the policy in place from 1958 that permitted small businesses expensing 20% of the cost of certain newly purchased equipment). See also Small Business Research and Development Enhancement Act of 1992, Pub. L. No. 102-564, 106 Stat. 4249; Small Business Reauthorization Act of 2000

government sought to enlarge the availability of funding,¹¹² relax the limitations on federally guaranteed loans, and encourage transactions with small businesses.¹¹³ It also collaborated with banking associations to provide joint long-term loans to small business.¹¹⁴

D. Small Business Culture Promotes Social Justice

Since many minority firms are small businesses, affirmative action is another positive result of small business culture.¹¹⁵ Financed primarily by personal and family savings, aiding small businesses has been seen as a way to aid minorities by encouraging their economic independence.¹¹⁶ Small businesses were sought as playing a central role in creating jobs and nurturing the advancement of minorities.¹¹⁷ Because Asians, Blacks, Hispanics and Native Americans have long faced discrimination in the workplace, fostering minority business ownership was considered an anti-

Pub. L. No. 106-554, 114 Stat. 2762. Both of these acts extended appropriations to small business loan programs.

112. Arlen J. Large, *R & D Funding for Small Firms Sets Off Big Fight in Congress*, WALL ST. J., Apr. 19, 1982, at 29. See 127 CONG. REC. 29,733 (1981) (statement of Sen. Warren Rudman) (“Let there be no mistake about this: S. 881 is not a small business relief bill. Rather, it is designed to address a specific problem in the most efficient manner . . .”)

113. For example, the Reagan Administration established the Small Business Innovation Research Program, a set aside program requiring federal agencies to allocate a share of their research and development budgets to small research and development firms. Small Business Innovation Development Act of 1982, Pub. L. No. 97-219, 96 Stat. 219.

114. *Long-Term Loans Offered to Small Firms in Joint Banking Industry-SBA Program*, WALL ST. J., Sept. 7, 1962, at 5; *SBA Boosts Ceiling For Interest Charges on Fixed-Rate Loans*, WALL ST. J., July 1, 1980, at 42; Sanford L. Jacobs, *SBA’s Plan to Cut Loan Rates Generates Lots of Opposition*, WALL ST. J., Oct. 26, 1981, at 29 (“None of this solves the basic problem of brutally high interest rates that many small companies simply can’t afford.”).

115. For example, in 2002, more than half of Black-owned businesses had less than \$10,000 in business receipts in 2002, compared with one-third of White-owned firms and 28.8 percent of Asian-owned firms. Asians had the smallest proportion of businesses—0.04 percent—with 500 or more employees, and these large firms accounted for less than 7 percent of Asian business receipts. See SMALL BUS. ASSOC., OFFICE OF ADVOCACY, *Minority in Business: A Demographic Review of Minority Business Ownership*, at 25 (2007), available at <http://www.sba.gov/advo/research/rs298tot.pdf>.

116. *Id.* at 13.

117. Press Release, S. Comm. on Fin., American Recovery and Reinvestment Act of 2009: Near 100 Percent of Finance Effects Will Come in First Two Years, 2 (2009) (on file with author) (“The finance business tax provisions are designed to help generate immediate cash [to small business] and prevent further job loss.”).

discrimination measure to improve their employment prospects and well-being.¹¹⁸

Small businesses have also been a place for women to get ahead.¹¹⁹ During World War II, when industrial jobs considered quintessentially masculine were transferred to women as part of the war effort, women began to gain respect and fair treatment in the workplace.¹²⁰ During the postwar period, American values returned to domesticity and familial roles of women. Still, small businesses offered an opportunity for women to earn money outside the home, even if the jobs were often fairly traditional.¹²¹ Employed women mostly worked in retail sales, personnel, and educational service, the so-called female ghetto.¹²² "The years in the mid-century essentially marked time for women in business, riding out the storms of economic and diplomatic collapse while witnessing incremental change in the number of women workers, managers, and entrepreneurs" concluded Angel Kwolek-Folland, a leading historian of women in American business.¹²³ At the end of the twentieth century, American women were

118. See, e.g., CHARLES V. DALE, CONG. RESEARCH SERV., RL33284, *MINORITY CONTRACTING AND AFFIRMATIVE ACTION FOR DISADVANTAGED SMALL BUSINESSES: LEGAL ISSUES* (2006); *Government Minority Small Business Programs: Hearing Before Subcomm. on Minority Small Bus. Enterprise of the H. Select Comm. on Small Bus.*, 92nd Cong. 351 (1972) ("These men have become owner-operators. They like to drive, but because of discrimination by the industry, the only way a black man can be assured of driving a truck is by buying the thing and running it himself."); *Availability of Credit to Minority-Owned Small Businesses: Hearings Before the Subcomm. on Fin. Institutions Supervision, Regulation, and Deposit Ins. of the H. Comm. on Banking, Fin., and Urban Affairs*, 103rd Cong. (1994); *Subcommittee Hearing on Minority and Hispanic Participation in the Federal Workforce and the Impact on the Small Business Community: Hearings Before the Subcomm. on Regulations, Health Care, and Trade of the H. Comm. on Small Bus.*, 110th Cong. (2008).

119. See, e.g., *U.S. Campaign Encourages Women to Own Businesses*, N.Y. TIMES, Aug. 6, 1977, at 33; Juanita M. Kreps, *Preparing Women to Be Entrepreneurs*, N.Y. TIMES, Sept. 17, 1977; Jennifer Roback, *Torn Between Family and Career? Give Birth To A Business*, WALL ST. J., Nov. 1983, at 30; *More Women Owning Businesses*, N.Y. TIMES, Feb. 23, 1984, at D-14; Steven P. Galante, *Composition of Delegates Reveals Rise of Women in Small Business*, WALL ST. J., Aug. 18, 1986, at 23.

120. RUTH MILKMAN, *GENDER AT WORK: THE DYNAMICS OF JOB SEGREGATION BY SEX DURING WORLD WAR II* 5 (1987).

121. *Id.* at 10.

122. *Id.* at 12.

123. ANGEL-KWOLEK-FOLLAND, *INCORPORATING WOMEN: A HISTORY OF WOMEN AND BUSINESS IN THE UNITED STATES* 168 (1998).

starting new businesses at twice the rate of men and owned almost a third of existing firms.¹²⁴

Over the years, government agencies altered their approach to small businesses, shifting from a neutral stance on race and gender to one with race and gender preferences.¹²⁵ Congress increased federal assistance programs and anti-poverty bills providing preferential treatment, grants, education, and jobs to help minorities and women.¹²⁶ The SBA boosted minority hiring within the agency and began to act against racial discrimination by lenders.¹²⁷ The SBA investigated complaints of racial discrimination and upon discovery of such conduct accelerated the loan maturity or took the borrower to court.¹²⁸ Affirmative action became a priority for the SBA, which created the position of Special Assistant for Minority Groups to supervise minority recruitment within the agency.¹²⁹ The SBA also founded the Women's Speaker's Bureau to encourage women to pursue business careers, to set aside top-level positions for women, and to authorize micro-loans to women-owned businesses.¹³⁰

Another path the government took to promote minority small business was developing a minority loan program with favorable conditions.¹³¹ It was

124. When discussing the Small Business Tax Fairness Act, Congressman William Reynolds Archer, Jr. (R-TX), Chairman of the Committee on Ways and Means, noted that 2000 would be the first year in our entire history where women will own more than half of all businesses, about 8 million, across the nation. 146 CONG. REC. 792, 843 (2000). In 2002, it was reported that of 22,974,655 existing firms, 6,489,259 firms (28.2%) were owned by women. YING LOWREY, U.S. SMALL BUS. ASSOC., OFFICE OF ADVOCACY, *Minority in Business: A Demographic Review of Minority Business Ownership 5* (2007), available at <http://www.sba.gov/advo/research/rs298tot.pdf>.

125. Scholars attributed this tendency to administrative pragmatism, reaction to the urban riots of the 1960s, or elitism. JONATHAN J. BEAN, *BIG GOVERNMENT AND AFFIRMATIVE ACTION: THE SCANDALOUS HISTORY OF THE SMALL BUSINESS ADMINISTRATION* 39 (2001).

126. Jonathan Spivak, *Poverty Fight Plans*, WALL ST. J., May 29, 1964, at 1. For example, as part of President Johnson's anti-poverty bill, the administration enabled the SBA to expand its limit for minority loans. *Id.*

127. BEAN, *supra* note 125, at 40.

128. *Id.* at 42.

129. *Id.* at 44.

130. *Id.* at 44. See also *More Aid for Small Businesses Proposed, With Emphasis on Minority Entrepreneurs*, WALL ST. J., Mar. 23, 1970, at 5; Johnnie L. Roberts, *After Rough Start, Venture-Capital Firm Finds Success Backing Minority Businesses*, WALL ST. J., Feb. 10, 1984, at 29.

131. *Business in Riots to Get SBA Loans*, WALL ST. J., July 31, 1967, at 26. President Johnson ordered the Small Business Administration to make long-term, low interest loans available to homeowners and small businessmen in riot-torn areas of Detroit to help them rebuild. *Id.*

well known that minority business owners found it harder to start a business in crime-ridden areas.¹³² They were refused loans by traditional lenders because they were considered to have a greater risk of failure than white business owners.¹³³ Yet for minority men and women, starting a business was a way to move up the economic ladder.

The government also created the Office of Minority Business Enterprise program at the SBA, which established Minority Enterprise Small Business Investment Companies (MESBIC) to encourage new minority businesses.¹³⁴ These programs sought to help Blacks, Mexican-Americans, Puerto Ricans, Native Americans, and others become businesspersons and offered incentives for corporations to locate plants in urban slums.¹³⁵ Yet, soon the MESBIC program was criticized for its inefficiency and for providing meager funding to minority small businesses.¹³⁶ Scandals related to the MESBIC program and investigations that revealed funds awarded through questionable grants further undermined the program's credibility.¹³⁷ Consequently, supporters of race-neutrality pressed Congress to open the program to the general "disadvantaged" population.¹³⁸

Naturally, when the government tried to alter its small business affirmative action programs such as scrutinizing the SBA Minority Development Program, it encountered political resistance.¹³⁹ Affirmative

132. Everett Groseclose, *A Black Businessman Finds It's Hard to Get New Firm Off Ground*, WALL ST. J., Sept. 17, 1969, at 1.

133. John A. Prestbo, *Going it Alone*, WALL ST. J., Apr. 10, 1969, at 1. (noting that many banks shun new business loans as too risky even when money is not tight).

134. S. SELECT COMM. ON SMALL BUS., *STUDY OF MINORITY BUSINESS ENTERPRISE PROGRAMS*, S. REP. NO. 95-629, at 109–10, 112–13 (1978). *See also* Darrin, *supra* note 32, at 472–73 (arguing that the SBIC/MESBIC program has not been successful in providing debt and equity capital to small businesses).

135. Monroe W. Karmin, *Minority Enterprise*, WALL ST. J., Mar. 26, 1969, at 20.

136. For example, in 1977 a task force of investment bankers concluded that SBIC/MESBIC assistance to small businesses was “inefficient and inappropriate, [and] that it reached only two-tenths of one percent of small business in existence at that time.” *Long-Term Implications of Current Budgetary and Economic Trends on Unemployment, Minority Business and Education: Hearing Before the Task Force on Human Cmty Res. of the H. Comm. on Budget*, 96th Cong. 74 (1979) (statement of Dr. Edward Irons). *See also* Burt Schorr, *Ailing Entrepreneurs*, WALL ST. J., Sept. 23, 1969, at 1.

137. BEAN, *supra* note 125, at 87. Note, for example, the Whitewater Scandal, one of the most known political scandals in 1999, when President Clinton was charged with influencing an SBIC to grant an SBA minority loan to a firm owned by the Clintons. *See infra* note 261.

138. BEAN, *supra* note 125, at 88.

139. Sanford L. Jacobs, *Trade Secrets... Minorities, SBA Clash... Malls Exhibitors*, WALL ST. J., Oct. 5, 1981, at 31 (“Minority Business supporters clash with the Small Business

action for minority businesses has been criticized for intensifying the segregation of minorities and their reliance on local markets.¹⁴⁰ Nevertheless, it remains a strong part of small business culture to this day maintained through the SBA 8(a) Business Development Program, the SBA Office of Native American Affairs, the Minority Business Development Agency, etc.¹⁴¹

IV. A NETWORK OF SELF-REINFORCING SMALL BUSINESS ORGANIZATIONS

Along with small business culture, institutional path dependence contributed significantly to the persistence of small business programs. Our nation's political and cultural organizations helped shape current small business benefit patterns. They assisted the government in determining which alternatives should be pursued to benefit the constituents they represent and at the same time reinforced their own existence.¹⁴² Three major small business organizations provided these self-reinforcement dynamics—the House and Senate Small Business Congressional Committees and the Small Business Administration. While these organizations were beneficial in serving as agents for, and promoting the interests of, small firms, they were also influential in blocking changes to the original path of small business programs. These organizations played a major role in leading Congress down a path from a traditional rational-based test, by which preferences are given to those who deserve them, toward an unrelenting favoritism of small business.

Through the establishment of certain agencies and organizations that created self-reinforcement dynamics, small business incumbents paved the path for small business institutional favoritism and, once created, shaped it over the years. During the 1940s, unique conditions allowed Congress to take

administration over SBA Administrator Michael Cardenas' efforts to limit the 8(a) program, which sets aside government contracts for minority companies. Mr. Cardenas wants to hustle some companies out of the program. Some have grown big. Some have abused the system and refuse to repay SBA advances. The SBA has proposed rules that would boot out companies after three or five years, depending on the type of business; those already in the program could be terminated sooner.”)

140. BEAN, *supra* note 125, at 53.

141. *Id.* at 90. Technically the SBA Minority Enterprise Program is color-blind and therefore has resisted constitutional challenge. See also, SBA, Minority Owned Businesses, available at: <http://www.sba.gov/content/minority-owned-businesses>.

142. See, e.g., *infra* notes 163–68.

a specific trajectory and form specialized small business committees.¹⁴³ These Select Small Business Committees and later the SBA played a central role in encouraging Congress to create, expand, and sustain small business programs.¹⁴⁴ Other Congresses continued this path, broadening the scope of small business programs, even when conditions did not warrant doing so. Rarely has Congress considered abolishing or limiting the small business programs; rather, it followed the SBA and the small business committees' recommendations to add funding authority and expand subsidies to small businesses.¹⁴⁵

A. *Congressional Small Business Committees*

During the 1940s, Capitol Hill officially opened its doors to small business, and it has not left since. The Senate Special Committee to Study and Survey Problems of American Small Business Enterprises was established in 1940 and its authority was later transferred to the Senate Select Small Business Committee.¹⁴⁶ In 1941, the House of Representatives established a committee to investigate the national defense program in its

143. See, e.g., Louis B. Schwartz, "Justice" and Other Non-Economic Goals of Antitrust, 127 U. PA. L. REV. 1076, 1077 (1979) (reviewing a list of 'interrelated' federal statutes of small business preferences, such as: the Reclamation Act of 1902, which limited the sale of water from federal irrigation projects to a single owner; the Public Utility Holding Company Act of 1935 that relaxed restrictions to large utility firms provided that local firms were left unharmed; the Small Business Act of 1942, which declared congressional policy to assure "small-business concerns [a] fair proportion" of government procurement contracts; and, the Surplus Property Act of 1944, which gave preference to small purchaser when disposing of federal war production facilities.)

144. The House Small Business Select Committee was formed in 1941 and was reauthorized every year until 1975 when it became a standing committee. The Senate Select committee is a standing committee formed in 1950. S. Res. 58, 81st Cong. (1950). In 1953, Congress enacted the Small Business Act of 1953, Pub. L. No. 83-163, 67 Stat. 232, which formed the SBA to "aid, counsel, assist and protect, insofar as is possible, the interests of small-business concerns." The SBA was made permanent in the Small Business Act of 1958, Pub. L. No. 85-536, 72 Stat. 384.

145. *Tax Revision Hearings Open; Relief for Small Firms Urged by Witnesses*, WALL ST. J., Jan. 8, 1958, at 9 ("The witnesses yesterday, urging tax help for small business . . . maintained the Government would not lose tax revenue from the changes since business activity and employment would expand as a result of the increased investment by the small firms.").

146. *Report of A Special Committee To Conduct Small Business Survey*, S. Res. 298, S.Rep. 2052, 76th Cong., 86 CONG. REC. 10708, 10865 (1940). See also PARRIS, *supra* note 10, at 172 (appointing special committee to study and survey problems of American small business enterprises).

relation to small business¹⁴⁷ that later was converted into the House Select Small Business Committee.¹⁴⁸ While these committees started with temporary mandates and no operative or legislative authority, they were re-approved every year until given permanent standing status.¹⁴⁹ Although unable to consider bills, the committees' mandates included inquiring generally into the problems of American small business, and proposing ways to advance and preserve the interests of small businesses.¹⁵⁰

These Small Business Committees have had considerable influence. They often hold hearings with scholars, businessmen, and government agencies and prepare reports urging the House and Senate to adopt or amend legislation. In the midst of merger waves, the Small Business Committees warned Congress of the threat to small businesses and suggested what steps lawmakers should consider in addition to tightening antitrust legislation.¹⁵¹ To improve the competitive position of small firms, the committees encouraged Congress to grant a greater proportion of government research and development contracts to small business concerns on a regular basis and promoted greater use of competitive bidding by the Pentagon in the

147. H.R. Res. 294, 77th Cong., 86 CONG. REC. 9418 (1941) (“[D]efense contracts are being given to the larger corporations, with whom the small manufacturer cannot compete, and that certain sections of the country are getting a disproportionate share of defense work while other sections are neglected.”) (statement of Rep. Sabath).

148. H.R. REP. NO. 68 (1947); H.R. Res. 18, 80th Cong. (1947).

149. The House Select Small Business Committee was given permanent status in 1974 as part of Rep. Bolling’s proposal to Rep. Hansen’s reform proposal of the House committees. H.R. Res. 988, 93d Cong. 120 CONG. REC. 33,705 (1974) (enacted). The Select Senate Committee became a standing committee in 1981. S. Res. 101, 97th Cong. 127 CONG. REC. 5130 (1981) (enacted). When the Senate unanimously approved the resolution to grant the small business committee a permanent status, it explained it was sending “a clear signal to the American people that the problems of small business are not to be ignored or forgotten.” 127 CONG. REC. 31940 (1981). On June 29, 2001, its name was changed to the Senate Committee on Small Business and Entrepreneurship. S. Res. 123, 107th Cong., 147 CONG. REC. 12,493 (2001) (enacted).

150. See, e.g., *Greater Federal Aid to Small Businesses Urged by House Unit*, WALL ST. J., Jan. 10, 1963, at 13. Consequently, small business committees were frequent initiators of leading small business acts in Congress. See, e.g., *Senate Unit Asks Change in Small Business Investment Program to Make It a “Success”*, WALL ST. J., Apr. 27, 1960, at 6. See also Arlen J. Large, *R&D Funding for Small Firms Sets Off Big Fight in Congress*, WALL ST. J., Apr. 19, 1982, at 29.

151. *Mergers Still Threaten Small Business, Says House Panel’s Report*, WALL ST. J., Nov. 9, 1962, at 3.

procurement contracts reserved for small businesses.¹⁵² Congress frequently followed these recommendations.¹⁵³

Nevertheless, the most significant contribution of these committees came in the creation of the SBA. The committees supervised the SBA and small business programs closely in a friendly capacity.¹⁵⁴ This was relatively easy given their similar mandates, common clientele, and friendships between committee and SBA members.¹⁵⁵ Although they lacked legal authority to control SBA activities, the committees exercised power to discuss and criticize the SBA's operations. They held extensive hearings on various government policy and program matters affecting small business and the SBA.¹⁵⁶ Having such allies in Capitol Hill helped small business organizations maintain and strengthen their influence in Congress and contributed to the perpetuation of their preferences.¹⁵⁷

152. *Senate Small Business Committee Urges More Bids in Pentagon Buying*, WALL ST. J., Jan. 13, 1961, at 7.

153. *Greater Federal Aid To Small Businesses Urged by House Unit*, WALL ST. J., Jan. 10, 1963, at 13. President Kennedy allocated a greater number of defense contracts to small business. *Id.*

154. *Higher SBA Loan Limit Backed by Senate Panel*, WALL ST. J., Sept. 17, 1980, at 3.

155. For example, many committee members continued to support the agency's actions even when they served on other committees and held other strategic positions. PARRIS, *supra* note 10, at 172.

156. For example, at some point the House committee called to abolish the SBA's Loan Policy Board for lack of efficiency in promoting small business loans. *See Wild Horses and Woolly Lenders*, WALL ST. J., Jan. 19, 1965, at 16. The committees' chairmen were considered very knowledgeable about small business, and had significant influence over the SBA. PARRIS, *supra* note 10, at 172–73. For the history of the long-time chairman of the Senate Small Business Committee between 1955 and 1967, Senator John Sparkman (D., Ala.), see *The Biography of John J. Sparkman at the John J. Sparkman Center*, REDSTONE ARSENAL, available at <http://www.redstone.army.mil/history/sparkman/sparkbio.htm> (last visited Sept. 17, 2012).

157. PARRIS, *supra* note 10, at 173 (reporting that Congressman Patman and Senator Sparkman both left their respective Small Business chairs to serve on the Banking and Currency Committees.) However, in 1981 the Senate Small Business Committee initiated a two-month investigation and hearings on SBA procurement practices. The committee found evidence of ignored procurement rules and of administration officials granting personal favors and pushing through contract awards without competition. Yet such incidents were exceptions to the general good relations between the committees and the SBA, as they both worked for the same cause of serving as the small businessperson's liaison in the government, preserving and promoting small business preferential treatment. Sanford L. Jacobs, *SBA's Procurement Practices Come Under Senate Scrutiny*, WALL ST. J., Apr. 27, 1981, at 33.

B. The Birth of the SBA

One of the most significant moments in small business history was the creation of the Small Business Administration. The SBA grew out of a series of agencies tracing back to the Reconstruction Finance Corporation (RFC) from the times of the Great Depression, and was modeled after the War Finance Corporation of World War I (both of which supported state and local government loans to banks, railroads, and firms of all sizes).¹⁵⁸ By 1942, large industries were enjoying a big share of wartime defense contracts, and Congress became concerned about the state of competition. To promote the participation of small businesses in war production and give them financial viability, Congress created the Smaller War Plants Corporation (SWPC).¹⁵⁹ The SWPC offered direct loans, encouraged financial institutions to provide credit to small firms, and urged federal agencies and big businesses to increase the participation of small business in procurement contracts. Yet the SWPC was soon dissolved, and its lending authority was dispersed due to criticism regarding its lack of information and expertise.¹⁶⁰

Following dissolution of the SWPC, the Senate Small Business Committee proposed a bill to create a new small business agency.¹⁶¹ On July 30, 1953, President Eisenhower signed the Small Business Act, which created the Small Business Administration in order to provide a government source of funding for small business — a temporary agency set to expire on

158. PARRIS, *supra* note 10, at 5.

159. C. WRIGHT MILLS & MELVILLE J. ULMER, SMALL BUSINESS AND CIVIC WELFARE: REPORT OF THE SMALLER WAR PLANTS CORPORATION TO THE SPECIAL COMMITTEE TO STUDY PROBLEMS OF AMERICAN SMALL BUSINESS 364, 367 (1946).

160. The SWPC dissolved in 1945, and its lending and contract powers were disbursed between the RFC and the Office of Small Business (OSB) in the Department of Commerce. During the Korean War, Congress attempted again to assist small businesses by creating the Small Defense Plants Administration (SDPA) with a mandate similar to the SWPC's (excluding lending authority, which remained in the hands of the RFC). Amid calls to abolish the RFC in 1952 because of some dubious loans it had made, the Senate Committee on Banking and Currency created a subcommittee headed by Senator William J. Fulbright (D., Ark.) to hold hearings and investigate allegations of corruption by the RFC's leaders. PARRIS, *supra* note 10, at 4–18.

161. Small Business Act of 1953, Pub. L. No. 83-163, 67 Stat. 232. In the Small Business Act, Congress authorized the SBA to make direct and “guaranteed” loans to small businesses; directed it to provide technical and management assistance to small business concerns; authorized it to enter into contracts with federal agencies and then sublet those contracts to minority firms under Section 8(a) of the Act; and directed it to assist small businesses in obtaining government contracts. *Id.*

June 30, 1955.¹⁶² Disappointed with the effect of antitrust laws and encouraged by the congressional select small business committees, Congress repeatedly re-affirmed the SBA. With the support of congressional small business committees, the SBA soon became a permanent agency and was sought after as the official source of information for various agencies on how proposed legislation would affect small business.¹⁶³ At times, it seemed that Congress had handed the SBA unsolicited authority.¹⁶⁴

The SBA's most significant mandate was to narrow the equity gap of small business funding, and increase the supply of credit.¹⁶⁵ Since its establishment, the SBA has initiated and developed various small business

162. Historian Jonathan Bean summarized Congress's purpose in establishing the SBA:

The primary legislative intent was to retain a governmental source of credit for small business Anticomunist ideologues supported the creation of a small business agency to defend independent enterprise from the 'Pinkos and the Marxist Reds' who threatened the American Way of Life. Clearly, the shades of meaning invested in the SBA were as varied as the small business ideology itself. The only losers were the laissez-faire conservatives

JONATHAN J. BEAN, *BIG GOVERNMENT AND AFFIRMATIVE ACTION: THE SCANDALOUS HISTORY OF THE SMALL BUSINESS ADMINISTRATION* 9–10 (2001) (internal footnotes omitted).

163. In 1955, although the Small Business Administrator only requested Congress to extend the life of the Administration for two years, the Chairman of the Senate Small Business Committee proposed instead to grant the SBA permanent status, stating "To abolish the Small Business Administration altogether would be such an obviously backward step To allow the agency to drift, uncertain of its future, would jeopardize the large investment on services and in appropriations already made." 101 CONG. REC. 7638 (1955) (statement of Sen. Thyne (R., Minn.)). See also *Agency Proposes Rise In Small Business Role In Federal Contracting*, WALL ST. J., Feb. 23, 1962, at 2 ("The [SBA] proposed new rules designed to broaden small business participation in Government contracting.").

164. At one time, the SBA rejected additional authority the Senate had tried to give it in determining government procurement policy:

The [SBA] told irritated Democratic Senators that it opposes their plans for the S.B.A to assume a major role in determining Government procurement policy.

. . . .

Moreover . . . the S.B.A was less than enthusiastic over another provision of the bill which would give the agency an additional \$75 million for loans to small businesses.

Small Business Agency Opposes Bill Giving It Role in Government Contract Policy, WALL ST. J., Mar. 16, 1961, at 28. Later, the SBA revised its position. See *SBA Alters Plan to Help Small Firms Get Federal Orders; Asks More Lending Funds*, WALL ST. J., Apr. 17, 1961, at 5.

165. See *supra* note 4 and accompanying text. See also Richard J. Judd & Barbra K. Sanders, *Regulation, Small Business, and Economic Development: A Historical Perspective on Regulation of Business*, in POLICY STUDIES ORGANIZATION, *SMALL BUSINESS IN A REGULATED ECONOMY: ISSUES AND POLICY IMPLICATIONS* 223 (Richard J. Judd et al. eds., 1988).

lending programs.¹⁶⁶ The SBA routinely requests greater funding authority,¹⁶⁷ even though the efficiency of its lending programs to small business has often been questioned.¹⁶⁸ Among its efforts to improve the availability of small business funding, the SBA frequently advocates for legislation to offer financial assistance and bolster the sagging small business credit program.¹⁶⁹

C. *The Establishment of the SBIC Program*

In 1958, the combined efforts of the congressional small business committees and the SBA were successful in creating the Small Business Investment Company (SBIC) program. The SBIC program was meant to expand funding to small businesses by creating cooperation between private investors and the government.¹⁷⁰ The program's principal function was to fill the "equity gap."¹⁷¹ This disparity between high demand for small business long-term finance and the availability of loans or equity-type credit to such

166. For example, in 1964 President Johnson and the SBA initiated a new lending program designed to target "Mom and Pop" stores with less than four employees. *Federal Lending Plan to Very Small Firms Disclosed; 514 Loans Already Made as Test*, WALL ST. J., May 27, 1964, at 6; Jonathan Spivak, *Poverty-Fight Plans: Administration Pushes For Fast Action Once Congress Passes Bill*, WALL ST. J., May 29, 1964, at 1.

167. An exception was noted in 1961 when the SBA rejected additional authority given to it by Senate; yet the SBA soon altered its position. *See supra* note 156.

168. *SBA Says Its Loan Activity Will Fall in Fiscal '60: But Official Asks House to Raise Lending Authority by \$150 Million for Fiscal '61*, WALL ST. J., May 25, 1960, at 30. Usually the SBA's requests were granted, and the agency continued to expand. *See Senate Panel Endorses Bill for SBA to Sell 'Participation' Loans*, WALL ST. J., Mar. 2, 1966, at 4; *Johnson's Plan to Sell Loans to Cut Deficit in Fiscal '67 Budget Is Opposed in Congress*, WALL ST. J., Apr. 1, 1966, at 8; *but see* Sanford L. Jacobs, *Small Business: Still Time for Pension Plan . . . Opting for Self-Employment*, WALL ST. J., Mar. 9, 1981, at 25. ("A deep cut in the Small Business Administration's loan authority is called for under Reagan budget-tightening. The agency had planned \$4.2 billion of lending for fiscal 1981, which ends Sept. 30. The President's budget-cutters want that figure reduced to \$3.5 billion.")

169. *Small Business Agency Seeks to Spur Loans by Commercial Banks*, WALL ST. J., Sept. 1, 1961, at 2 (noting the SBA was criticized for becoming the most rapidly expanding agency in Washington and for making too many loans).

170. Small Business Investment Act of 1958, Pub. L. 85-699, 72 Stat. 689. *See SBIC Program Reform Is Sent Congress; Would Broaden Financial Aid, Tax Benefits*, WALL ST. J., May 24, 1967, at 2.

171. John A. Prestbo, *Going it Alone: More Individuals Buck Alarming Rate To Start Own Firms*, WALL ST. J., Apr. 10, 1969, at 1 ("Many banks shun new business loans as too risky... and the SBA's loan funds are limited. As a result, neophyte businessmen frequently must seek financial backing from private investors in return for equity in the enterprise.")

concerns prompted a series of hearings in 1958.¹⁷² As a result, several bills were introduced to narrow the small business equity gap.¹⁷³ One of the proposals was the product of a collaboration between then-Senator Lyndon B. Johnston (D-TX) and Congressman John Wright Patman (D-TX), chairman of the House Select Committee on Small Businesses and co-author of the Robinson-Patman Act of 1936.¹⁷⁴

The Johnson-Patman Small Business Investment bill proposed the creation of a Small Business Capital Bank System.¹⁷⁵ The idea was for local banks to be funded by the Federal Reserve System to fulfill the long-term requirements for capital in their area without the need for periodic appropriations.¹⁷⁶ A new independent Small Business Investment Administration would supervise those banks, since the new program was

172. U.S. BD. OF GOVERNORS OF THE FED. RESERVE SYS., 85TH CONG., FINANCING SMALL BUSINESS: REPORT TO THE COMMITTEES ON BANKING AND CURRENCY AND THE SELECT COMMITTEES ON SMALL BUSINESS 13–14 (Comm. Print 1958); *Financial Institutions Act of 1957 Part 2: Hearing on S. 1451 and H.R. 7026 Before the H. Comm. on Banking and Currency*, 85th Cong. 1548 (1958).

173. A Senate report described the legislative intent behind the Small Business Investment Act of 1958:

This bill is the result of extensive hearings and careful consideration of the long-term credit and equity needs of small businesses by the Committee on Banking and Currency in both sessions of the 85th Congress. In the 1st session of the 85th Congress, the committee held extensive hearings on S. 719, S. 2160, and S. 2286, but deferred action upon these bills pending the results of a study on financing small business by the Federal Reserve System.

....

In the present session of Congress, hearings on this subject were continued and included consideration of S. 2160, S. 2185, S. 2286, S. 3191, S. 3643, and S. 3651. Upon conclusion of these hearings, the committee considered all of these bills and determined to report S. 3651

S. REP. NO. 85-1652, at 1 (1958).

174. Robinson-Patman Act, 15 U.S.C. § 13 (West 2011).

175. Representative John W. Patman (D., Tex.) made the following statement:

I propose that the capital stock of each one of the 12 small-business capital banks be \$10 million. The money will not have to be borrowed by the Government and the Government will not have to pay interest on it. It will be gotten from the Federal Reserve banks out of their surplus funds.

Financial Institutions Act of 1957: Hearing on S. 1451 and H.R. 7026 Before the H. Comm. on Banking and Currency, *supra* note 166, at 1548. A similar bill was introduced in the Senate by Johnson. However, the Banking and Currency Committees of the Senate and the House did not report these bills. Thereafter, on April 21, 1958, the majority leader in the Senate, Senator Johnson, introduced S.3651, which later passed the House with amendments. H.R. REP. NO. 85–2718, at 35 (1959).

176. 104 CONG. REC. 10,512 (1958) (statement of Sen. Sparkman).

viewed as having different purposes and separate types of financing mechanisms from the small-scale disaster and distress loans the SBA had managed thus far.¹⁷⁷ In essence, the new program sought to expand the flow of long-term debt and capital equity to small concerns that were regarded as too much of a credit risk for conventional lenders or even for the SBA's own direct loans. In retrospect, the Johnson-Patman Small Business Investment bill would probably have created a more efficient solution than the SBIC program. If approved, the bill would have created an agency free from the need for repeated appropriations from Congress, operated by financiers and bankers, and most importantly, it would have been an independent agency supervised by a professional authority on funding.¹⁷⁸

The Federal Reserve, however, objected to supervising the proposed new agency. This, combined with opposition from the SBA and the congressional select small business committees, put the Johnson-Patman Small Business Investment bill to rest. On August 21, 1958, Congress adopted a different version put forward by Senator Edward Thye (R-MN), chairman of the Senate Small Business Committee. The revised version abandoned the idea of an independent agency as well as the idea of non-appropriated financing, and created the SBIC program as a division of the SBA under the supervision of a deputy administrator.¹⁷⁹ A few Republicans objected to the interference of the federal government in the private sector, arguing that Congress should focus on strengthening existing SBA programs.¹⁸⁰ Nevertheless, Congress adopted the new SBIC program with the express purpose:

[T]o improve and stimulate the national economy in general and the small- business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion,

177. "First, the individual investment decisions should be made, not by a bureau in Washington, but by local businessmen who will be backing their decisions with substantial amounts of their own money. The second goal of the system is that it should provide for private capital to come in and take over complete ownership and operation of the system." H.R. REP. NO. 85-2718, at 35 (1959).

178. *Id.*

179. Small Business Investment Act of 1958, Pub. L. No. 85-699, § 201, 72 Stat. 689, 690.

180. 104 CONG. REC. 10,529 (1958) (individual views of Sen. Capehart, Sen. Bricker, and Sen. Bennett) ("This bill should be defeated . . . It would be more realistic and practical for the Congress to strengthen the existing programs of the Small Business Administration rather than to perpetrate this new intrusion by the Federal Government into private business."). For a review of the legislative history of the Small Business Investment Act of 1958, see PARRIS, *supra* note 10, at 155.

and modernization, and which are not available in adequate supply . . .

¹⁸¹

As enacted, the SBIC program provided for cooperative public and private funding. The Small Business Investment Act provided for the formation of small business investment companies licensed by the SBA and chartered by the states¹⁸² with no less than ten investors and a minimum of certain “statutory capital.”¹⁸³ Each SBIC was authorized to make long-term loans for a maximum duration and interest set by the SBA, or to buy debt instruments convertible into stock from small business firms. To facilitate this program, the government provided federal capital to SBICs in the form of loans or debt instruments granted through the SBA. Additionally, the government matched half of the SBICs’ paid-in capital through federal loans; for every dollar put up by private investors for an SBIC, the government put up twice that amount.¹⁸⁴ For example, the Small Business Investment Act of 1958 required a minimum of \$150,000 of private funds invested in an SBIC before it could receive a license. While an SBIC was required to have \$300,000 of total initial capital, the private investors could start the company with only \$150,000, receive another \$150,000 from the SBA by issuing debentures, and another \$150,000 from the SBA through special loans. Therefore, for every dollar private investors provided, the government matched two dollars of the minimum capital needed.¹⁸⁵ In addition, investors in SBICs enjoyed generous tax concessions from the government that were meant to encourage their participation in small business investment.¹⁸⁶

181. Small Business Investment Act of 1958, Pub. L. No. 85-699, § 102, 72 Stat. 689.

182. *Id.* § 301, 72 Stat. at 691.

183. *Id.* § 302, 72 Stat. at 692.

184. *Id.* §§ 301–03, 72 Stat. at 691–93.

185. *Id.*; see also Burt Schorr, *Spotlight on SBICs: SBA Summoning Operators of Many Firms As Prelude to Possible Disciplinary Steps*, WALL ST. J., Jan. 12, 1967, at 28. For the amendments made to the Small Business Investment Act, see PARRIS, *supra* note 10, at 157–60; SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON GOV’T OPERATIONS, 90TH CONG., INVESTIGATION INTO SMALL BUS. INV. COMPANIES 4 (Comm. Print 1968). At some times, the government provided \$3 dollars per \$1 of private investment. *Full Committee Hearing on Increasing Investment in Our Nation’s Small Businesses Before the H. Comm. on Small Bus.*, 110th Cong. 53 (2007) (statement of Stephen Vivian, Nat’l Ass’n of Small Bus. Inv. Companies).

186. For example, Congress granted SBIC investors ordinary loss treatment instead of the limited capital loss treatment, a 100% dividend deduction received from small businesses, etc. The SBA acted to expend these tax benefits to SBICs in order to encourage investors. See *SBA Consultant Urges Tax Law Changes To Spur Small Business Investment Firms*, WALL ST. J., May 21, 1959, at 3.

One of the key innovations of the SBIC program was its ability to make direct investments in the equity of small business.¹⁸⁷ Up to that point, SBA activity focused on guaranteeing loans and not engaging in equity financing, a task that required greater supervision and human resources the SBA did not have. The novel change in this position came through the SBIC program, which added private capital to the equation and involved investors that took charge of these tasks.¹⁸⁸ Yet the SBIC soon proved that combining government programs with private market capitalism is not necessarily a recipe for a successful business plan and the SBIC Participating Securities program was eliminated.¹⁸⁹

V. LOCKED IN AN INEFFECTIVE PATH

As soon as Congress created the SBIC program, the numbers of participants grew rapidly. Nevertheless, their performance was underwhelming.

[T]he record of the SBIC industry after a decade is far from impressive. Indeed, one could well question whether the whole exercise is worth the effort.

Profits have been meager by any yardstick. It was not until the year ending March 31, 1967, that the SBIC industry ever showed an over-all profit¹⁹⁰

187. Small Business Investment Act of 1958, Pub. L. No. 85-699, § 304, 72 Stat. 689, 693.

188. “Whenever a company provides capital to a small-business concern under this section, such concern shall be required to become a stockholder-proprietor of the company by investing in the capital stock of the company, in an amount equal to not less than 2 percent nor more than 5 percent of the amount of the capital so provided, in accordance with regulations prescribed by the Administrator.” *Id.* § 304(d), 72 Stat. at 693.

189. *See, supra* note 22. *See also*, Joseph W. Bartlett, *Government-Enhanced Equity Available for Investment in Traditional Venture Capital and Buyouts: The New SBIC Participating Securities Program*, 1994 COLUM. BUS. L. REV. 589, 612–15 (1994) (SBIC participating securities program is inefficient in closing the small business equity gap).

190. PARRIS, *supra* note 10, at 160. *See also* Elizabeth M. Fowler, *S.B.I.C. Program Has Growth Pains*, N.Y. TIMES, Sept. 18, 1966, at 155 (“232 of the S.B.I.C.’s could be called ‘problems.’ Some have never gotten started investing; some have heavy losses; some have violated S.B.A. regulations.”).

A. Early Problems of the SBIC Program

From its inception, the success of the SBIC program was questionable. Critics of the SBIC program argued that it simply threw “cheap money” at small business.¹⁹¹ Although the Small Business Committees reported that SBICs were prosperous and successful,¹⁹² their contribution to narrowing the equity gap was minor and controversial.¹⁹³ The number of new SBICs shot up soon after the program was established, but soon began to fluctuate, and after about 25 years interest in the program waned. By the early 1980s, the number of SBICs opting out of the program, voluntarily or via liquidation, generally exceeded the number of new licenses. As a result, the number of SBICs since the mid 1980s has been decreasing.¹⁹⁴ One of the reasons for this phenomenon is that investors in SBICs were not aware of what they were getting into; they were enticed by the idea of tax incentives and the privilege of borrowing from the government without fully assessing the effects of risky investments, declining stock markets, and heavy compliance costs.¹⁹⁵

191. *Small Business and Big Government*, WALL ST. J., Oct. 26, 1960, at 16 (arguing politicians hawked “‘cheap’ money and bigger Government.”).

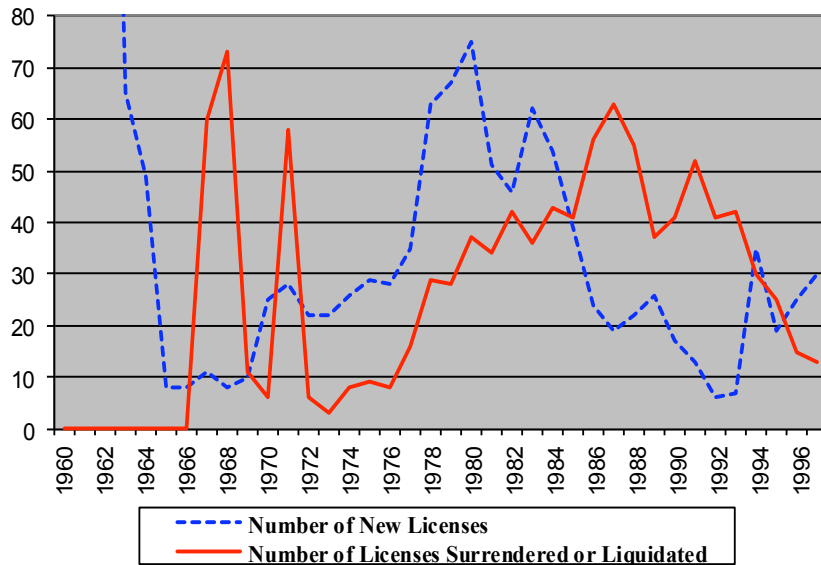
192. H.R. REP. 87-2569, at 45 (1963). (“During the 87th Congress small business investment companies have achieved substantial growth in numbers, the number of dollars available from this source for investment purposes, and in public acceptance.”).

193. See, e.g., *supra* note 204 and accompanying text.

194. Some of the figures are also attributed to mergers as well that SBICs experienced at that time. See, e.g., *Takeover Targets: New Bosses Liquidate Some SBICs, Switch Investments of Others*, WALL ST. J., Mar. 17, 1967, at 1.

195. *Shaky SBIC’s: New Investment Firms Hobbled by Stock Drop, Government Red Tape*, WALL ST. J., Jul. 16, 1962, at 1 (“Within the next five years, half of the 600 companies now in the program probably won’t be around.”) (internal quotation marks omitted); Sanford L. Jacobs, *Firms Find Harsh Provisions In Hazardous-Waste Statutes*, WALL. ST. J., Sept. 12, 1983.

Figure 1-SBIC License Activity 1960-1997



Source: SBA, SBIC Program Statistical Package (Jan. 1998)

Stories about misuse of government money and violations of SBA regulations began to appear in the press. Some SBICs voluntarily surrendered their licenses, liquidated, or merged because of lack of profitability.¹⁹⁶ In 1966, the Senate Banking and Currency Subcommittee on Small Business held hearings and reported that the number of SBICs in financial trouble increased sharply as the program progressed.¹⁹⁷ That year, the Senate Permanent Committee on Investigations conducted hearings regarding failures of federally insured banks and revealed similar abusive practices in the SBIC context. Consequently, closer investigation of the SBIC companies and their operations revealed the following problems with the SBIC program and its SBA supervision.¹⁹⁸

196. This was mainly due to low profitability. See *Mid-States Business, A Small-Business Firm, Proposes to Liquidate*, WALL ST. J., Apr. 24, 1964, at 5; *Southwestern Capital Directors Will Attempt To Dissolve Company*, WALL ST. J., May 15, 1964, at 10.

197. SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS, REP. ON INVESTIGATION INTO SMALL BUS. INV. COMPANIES, S. REP. NO. 90-958, at 5 (1968) [hereinafter SENATE SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS REPORT].

198. *Id.*

1. Human Capital Problems

In the early days of the program, individual investors often sought to make a fast profit.¹⁹⁹ Yet they acted without the proper knowledge of how to manage small businesses successfully and did not comprehend the unique problems facing small concerns.²⁰⁰ In most cases, the SBA encouraged the formation of new SBICs by generously granting licenses with few limitations and inadequate supervision.²⁰¹ The SBA carried out little or no investigation into the individuals requesting SBIC licenses — failing to examine their character, reputation, business experience and qualifications to make prudent loans — so fraudsters began taking advantage of the program.²⁰² Despite efforts to improve the standards for granting new licenses, the SBA did not have an adequate independent examination mechanism for the SBIC program.²⁰³

The SBICs' boards of directors were the most important element in the SBICs' valuation processes of small business portfolio securities. Therefore, managing the risk each SBIC took upon itself was largely a mutual decision of its board of directors. Accordingly, their knowledge, skill, ability, and integrity were key factors in investment valuations. Further, while obtaining information, learning processes and procedures and requiring proper documentation and reporting from the prospective small business firm were helpful, the portfolio ultimately required management to make a proficient decision.²⁰⁴ One of the severe weaknesses of SBICs throughout their history

199. In February 1966, for the first time, the SBA began to require prior approval to any change in control or ownership of an SBIC. *Id.* at 8. (testimony of Bernard Boutin, Administrator of the Small Business Administration).

200. *Id.*

201. See *Small Business Administration Preparing Loan-Guaranty Plan for Investment Firms*, WALL ST. J., Dec. 8, 1964, at 9 (discussing how in its attempts to spur loans to small business and in light of its own reserves' depletion, the SBA proposed a loan-guaranty plan for SBICs that would require it to put aside less money for reserves).

202. See *Spotlight on SBICs*, WALL ST. J., Jan. 12, 1967, at 28 (“[T]he rising number of court actions against SBICs being initiated by the Justice Department in the SBA’s behalf to recover Government funds. At year-end, over 60 such cases were pending in court, triple the number of a year earlier . . . Collectively, the companies named so far as defendants owe Uncle Sam approximately \$22 million.”).

203. See generally *Review of Small Business Administration’s Programs and Policies, 1969: Hearings Before the S. Select Comm. on Small Bus.*, 91st Cong. 1 (1969); see also *SBIC Chief Calls 232 of the 700 Companies ‘Problem’ Firms, Warns of \$18 Million Loss*, WALL ST. J., June 15, 1966, at 2.

204. In the 1990s hearings of the Committees, the valuation process was identified as a severe weakness in the SBIC program. SENATE SUBCOMM. ON INVESTIGATIONS AND GOV’T OPERATIONS REPORT, *supra* note 197, at 10–11. See also S. REP. NO. 102-44 (1991), at 35–37.

was the ineffectiveness of this human factor, which was in charge of making the subjective final valuation decision, but did not have direct expertise and the skill set unique to managing small business concerns.²⁰⁵

Lack of managerial expertise and lack of proper guidance from the SBA were some of the main reasons for the program's failure.²⁰⁶ SBICs did not possess and were not offered sufficient knowledge about the types of businesses they sought to support. While some SBICs provided consulting services to small firms for a small fee,²⁰⁷ due to their limited resources, they could not afford the appropriate staff needed to supervise investments. Many managers of SBICs soon discovered that small businesses became high credit risks and defaulted on their loans, contributing to a high rate of SBIC failures.²⁰⁸

2. Agency Costs

a. Poor Risk Management

It is no secret that investments in small businesses are more precarious than those in large ones. Consequently, aside from systemic risks associated with external conditions such as national and regional economic and financial cycles, SBICs are exposed to greater risks due to their focus on small business ventures.²⁰⁹ Most of these transactions involve venture capital

205. See SENATE SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS REPORT, *supra* note 197, at 45 ("Conflicts of interest and self-dealing transactions, including 'bootstrapping' and 'cross-dealing', were prevalent in the program.").

206. Roger W. Benedict, *Shaky SBIC's: New Investment Firms Hobbled by Stock Drop, Government Red Tape*, WALL ST. J., Jul. 16, 1962, at 1 ("[M]any persons in the SBIC's got into the business for the wrong reasons and with the wrong abilities The 'irresistible' lure of the special tax advantages and the Government loans at reasonable terms brought many into the industry.") (internal quotation marks omitted). See also Burt Schorr, *Spotlight on SBICs: SBA Summoning Operators of Many Firms as Prelude to Possible Disciplinary Steps*, WALL ST. J., Jan. 12, 1967, at 28 ("This program [SBIC] was oversold," says an SBA official overseeing the cleanup drive. "Too many SBIC operators looked on it as a way to make a fast buck.")).

207. The SBA initiated a plan aimed at encouraging up to five SBICs to hire central management and share office space with other SBICs hoping their work together would lead to their merger. See *SBIC Chief Calls 232 of the 700 Companies 'Problem' Firms, Warns of \$18 Million Loss*, WALL ST. J., June 15, 1966, at 2.

208. *Id.*

209. See generally Elijah Brewer III et. al., *A Trojan Horse or the Golden Fleece? Small Business Investment Companies and Government Guarantees* (Fed. Reserve Bank of Chicago, Working Paper No. 22, 1997), available at http://www.chicagofed.org/digital_assets/publications/working_papers/1997/wp97_22.pdf.

— that is, primary risk capital provided to small firms in their early and difficult formative periods.²¹⁰

Furthermore, the constricted profit potential of many SBICs contributed to their failures. After granting a long-term loan to a small business, SBIC's only source of income was the spread between the interest the SBIC had to pay to the SBA and the interest and the fees the SBIC collected from its loans or the capital gains it realized on its investments, if any.²¹¹ Yet the SBIC also had high costs to cover. Aside from the interest the SBIC owed on government loans, it usually incurred expenses such as rent, utilities, travel, salaries, and investigating and consulting costs on new loans and investments.²¹² If any profit remained after deducting those costs and absorbing any losses incurred on failed investments, the SBIC had to distribute dividends to its stockholders, who were looking to recover their investments.²¹³ As a result, many SBICs' executives chose to funnel their low-cost federal money into high-return real estate ventures — a practice the SBA did not restrict.²¹⁴

Shortly after its establishment, the SBIC program seemed to be providing most loans to large, publicly held investment companies.²¹⁵ Ironically, because of the large sunken costs, SBICs preferred to invest in midsize firms.²¹⁶ The relative profitability of the SBIC program was due only to the shift away from lending to small business and toward larger loans to bigger businesses, contrary to the program's objective.²¹⁷ This trend shut the

210. S. REP. NO. 102-44, at 14 (1991).

211. *Id.* at 4–6.

212. *See, e.g.*, Kenneth G. Slocum, *Rise of the SBIC's: Federally-Aided Units Triple in Number, Pool Funds for Bigger Loans*, WALL ST. J., Sept. 8, 1961, at 1 (discussing the large legal fees and investment SBIC has to expense for every loan it administers, which makes it less profitable to loan to small business and more to medium businesses).

213. *Id.*

214. Burt Schorr, *Spotlight on SBIC's: SBA Summoning Operators of Many Firms as Prelude to Possible Disciplinary Steps*, WALL ST. J., Jan. 12, 1967, at 28.

215. *Id.* (citing Walter B. Stults, staff director of the Senate's Select Committee on Small Business, which conducted a constant study of how the program is functioning.) *See also* Burt Schorr, *Takeover Targets*, WALL ST. J., Mar. 17, 1967, at 1.

216. *Halt Urged in Adding New Small Business Investment Concerns*, WALL ST. J., Oct. 10, 1961, at 4 (“[S]mall business investment corporation is gravitating more and more toward big and speculative ventures.”).

217. George Melloan, *Rise of the SBICs Federally-Aided Unites Set Up to Lend to Small Business, Expand Fast— more Sell Stock to Public: Critics Say Some Aid Only Fast-Growing Companies*, WALL ST. J., Sept. 28, 1960, at 1 (“The entrance of big, publicly held S.B.I.C.'s into the field . . . is leading to the shift away from very small borrowers toward bigger companies that have prospects for growth to a size where their securities will qualify for listing on stock markets or be actively traded over the counter.”).

door on the same people Congress was trying to help. Eventually, the program recuperated from its stagnate state when banks were authorized to form small business investment subsidiaries.²¹⁸

b. Deficiencies in the SBA's Monitoring of SBICs

During the 1960s, the SBA faced serious repayment problems and the SBIC program was called into question.²¹⁹ One Wall Street Journal staff reporter wrote:

When the Government set out to solve the capital problems of small businessmen, its intention may have been excellent . . . its achievements are nonetheless dismal As the sorry saga of the SBICs shows once more, however, the interests of the nation are usually served best if all other avenues are explored first before turning over yet another task to fumbling Federal fingers.²²⁰

The Small Business Investment Act of 1958 imposed on the SBA a duty to supervise and regulate the SBIC program.²²¹ Assuming that responsibility, however, proved to be difficult. The SBA was blamed for its failure to administer the SBIC program and prevent the increasing numbers of SBIC failures or their delay in providing new loans.²²² For the program's first eight years, the SBA made no effort to determine the basic factors necessary for the profitable operation of SBICs.²²³

One reason for this malfunction was that the SBA was not equipped with the knowledge or expertise to supervise and manager investment companies. The SBA's accounting system and financial records, which did not provide

218. See *Marine Midland Seeks to Form Small Business Investment Company*, WALL ST. J., Aug. 25, 1960, at 15; Melloan, *supra* note 217, at 1. For bank-owned SBIC today see, *infra* note 269 and accompanying text.

219. Burt Schorr, *Antipoverty Setback*, WALL ST. J., July 1, 1967, at 1. In 1967, it was estimated that the Government might lose about \$10 million on defaulted loans. It turned a blaming finger to the SBA for making poor choices of borrowers and inadequate counseling and supervision of those businesses. *Id.*

220. *A Fumbling Mr. Fix-it*, WALL ST. J., Mar. 23, 1967, at 14.

221. The Small Business Investment Act of 1958, 15 U.S.C. § 633 (1958).

222. *A Fumbling Mr. Fix-it*, WALL ST. J., Mar. 23, 1967, at 14 ("A number of the SBICs reacted by making no loans at all, eventually just going out of business. Others plunged right ahead and, not surprisingly, wound up with a raft of financial trouble."). See also *Mr. Boutin's Battle*, WALL ST. J., Apr. 19, 1967, at 18 ("Of the 434 SBICs examined by the SBA, only 38 showed no violations of the agency's regulations, and 28 were put under review to decide if a full investigation was needed.").

223. STAFF OF S. SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS, 90TH CONG., REP. ON INVESTIGATION INTO SMALL BUS. INV. CO. 45 (1968).

accurate, complete, or current information on the SBICs' performance.²²⁴ As a result, the SBA failed to inform itself about the status of its loans to SBICs or the expected government losses.²²⁵ The SBA was not able to make effective and timely evaluations of SBICs until they reached an "impairment of capital" status,²²⁶ a point when improving the financial conditions of those companies was virtually impossible.²²⁷

SBA standards and procedures to govern the licensing of new SBICs and changes in control of existing companies were inadequate.²²⁸ Individuals were not regularly required to report on investments they purportedly made and as a result, undesirable and unqualified individuals entered the program.²²⁹ Furthermore, the SBA did not set proper monitoring mechanisms and often made additional advances of government funds to troubled SBICs without a reasonable prospect to repay.²³⁰

The responsibilities of the SBA's investigatory staff exceeded its resources. Overload on the SBA's Office of the Inspector General was a big part of why the SBA was impaired in investigating SBICs.²³¹ While investigating the SBIC program, the Senate Subcommittee on Investigations and Government Operations reported that the examinations and investigations of SBICs by the SBA to detect conflicts of interest and other violations were inadequate. There was no program for regularly scheduled, routine examinations, and when examinations were made, considerable time elapsed between them. Consequently, when fraud, conflicts of interest, and

224. *Id.* at 12, 18, 45.

225. For example, in its 1966 report to Congress, the SBA estimated that 232 out of 699 SBICs were in trouble and that \$18 million of Government funds advanced to these 232 companies would be lost. *Id.* However, Bernard Boutin, who was appointed Administrator in May of 1966 rejected this figure and estimated loss to a total of over \$50 million. *Id.* Later, the SBA increased its reserve for losses to \$54.1 million as of March 31, 1967. *Id.* at 46

226. This status is defined by the SBA regulation as a loss of 50% or more of the privately invested capital, which increases the risk of the government losing all its funds. *Id.* at 9.

227. *Id.* at 14.

228. See *SBIC Chief Calls 232 of the 700 Companies 'Problem' Firms, Warns of \$18 Million Loss*, WALL ST. J., June 15, 1966, at 2.

229. *Id.* (noting that the SBA's administration and supervision of the SBIC program by the SBA was "lax" and inefficient).

230. *Id.*

231. COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 47 (1991) ("During the decade of the 1980s, the compliance examination program for SBICs was subjected to considerable impairment The SBA . . . suffered such impairments by the simultaneous increase in its responsibilities, and the curtailment or withholding of resources available to perform its mandated functions.").

mismanagement were found, the SBA's actions to protect the government's funds and help the SBICs' management were weak, indecisive, and ineffective, and were limited to correspondence and conferences with the SBICs' managers.²³²

The SBA also had problems enforcing its regulations.²³³ SBA rules did not expressly prohibit or penalize conflicts of interest within a SBIC operation, and in fact, they allowed self-dealing and cross-dealing transactions as long as they were reported to the SBA.²³⁴ And even when violations existed, the SBA's enforcement was practically non-existent, mostly because there were no penalties set for violating the agency's regulations.²³⁵

At the end of the 1960s, the SBA tried to assume responsibility and began to investigate violations of its regulations.²³⁶ The SBA took disciplinary action against several executives of SBICs,²³⁷ and tightened its licensing standard for new SBICs.²³⁸ Yet, the SBA soon loosened its

232. *Review of Small Business Administration's Programs and Policies—1969, Hearings Before the S. Select Comm. on Small Bus.*, 91st Cong. (1969); S. SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS, 90TH CONG., REP. ON INVESTIGATION INTO SMALL BUS. INV. CO. 45 (1968).

233. Deputy Administrator for the SBIC program, Richard E. Kelley, reported that when he took over the position, the SBA's examination program collapsed and 75% of all companies were never examined at that time. *Id.* at 19.

234. The phrase "self-dealing" refers to interlocking dealings between those who grant the money and those who get it. "A majority of the nation's 600-plus SBICs apparently still avoid self-dealing." *Double Standard*, WALL ST. J., July 2, 1963, at 1; see also *Mr. Boutin's Battle*, WALL ST. J., Apr. 19, 1967, at 18. For the first decade of its operation, the SBA officials believed existing SBA regulations were adequate to control conflicts of interest. S. SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS, 90TH CONG., REP. ON INVESTIGATION INTO SMALL BUS. INV. CO. 10-11 (1968).

235. For example, the Comptroller General of the U.S. reported to the Senate, "A primary basis for selecting an SBIC for examination was apparently its proximity to one of the SBA field offices." *Id.* at 14.

236. *Id.* at 49 (In 1966, "Mr. Boutin further reported that he feels the SBIC program as it now stands is unworkable; that it needs a completely new approach or it will deteriorate further from an already shaky position.").

237. *Drive to Police Small Business Investment Firms Is Successful, Federal Aides Say*, WALL ST. J., Mar. 3, 1962, at 4. The SBA also proposed rules to halt investors who were looking to buy out publicly held SBICs below liquidation value by refusing to allow such liquidation if during the preceding year a "major change" had occurred in the board of directors or in parties controlling 10% or more of its stock. *SBA Aims to Spur Mergers, Curb 'Raiding' of Small Business Investment Companies*, WALL ST. J., May 30, 1964, at 4.

238. For example, in 1964, the SBA had ordered a 90-day freeze on its licensing of SBICs and announced stricter standards would be laid down in the fall because many SBICs were part-time operations that were just sitting still and were not performing the role Congress

supervision to avoid discouraging SBIC investment activity.²³⁹ Congressional actions to provide the SBA with greater enforcement authority were not enough to keep the SBIC program on track.²⁴⁰ Almost yearly, the SBA's Office of the Inspector General continues to report deficiencies in the SBA's own oversight of the SBIC program in its annual report.²⁴¹

B. SBICs Today

During the last half century, the SBIC program has widely been considered faulty.²⁴² At many points, SBICs were at a crossroads, when their

intended to SBICs. The SBA was also worried that more than half of the 717 SBICs were clustered in just six states. *See U.S. Orders Halt to New SBICs For the Next 90 Days*, WALL ST. J., July 6, 1964, at 2; *see also Small Business Agency Fights Parts of Senate Investment Firm Bill*, WALL ST. J., Aug. 1, 1961, at 3. The SBA required SBICs to have a full time responsible officer with five years investment banking experience, maintain an office accessible to the public, maintain a minimum of private capital, and banned family relationships between stockholders. *SBIC Licensing Standards Made More Stringent*, WALL ST. J., Oct. 16, 1964, at 5.

239. *Small Business Administration to Propose Stiffer Curbs on Conflict-of-Interest Loans*, WALL ST. J., Aug. 6, 1964, at 2 (“Generally, officials say the agency’s current policy is to liberalize regulations governing the investment companies’ day-to-day operations where possible, in order to minimize Government interference.”). Deputy Administrator James Parris, who authorized SBIC self-deals, commented, “Our main concern is securing capital for small businesses. We don’t want to bog small SBICs down with too many regulations.” *Double Standard*, WALL ST. J., July 2, 1963, at 1; *see also Eric Wentworth, SBA Studies Proposals Aimed at Improving Profit of Small Business Investment Firms*, WALL ST. J., Nov. 17, 1964, at 10; Burt Schorr, *Spotlight on SBICs*, WALL ST. J., Jan. 12, 1967, at 28 (noting that the big problem confronting the SBA is “[d]evising regulations tight enough to protect the taxpayer’s \$275 million investment in these companies without crippling their ability to finance risky small business enterprises, the role Congress intended”).

240. *Bill for Tighter SBIC Rules*, WALL ST. J., Sept. 1, 1966, at 3. (“A bill to tighten Government regulation of small business investment companies was approved by a Senate banking subcommittee” giving the SBA “power to revoke SBICs licenses after administrative proceedings[.] . . . power to remove or suspend [SBICs] officers and directors” for issuing cease-and-desist orders against individuals and SBICs that had violated regulations, and authorizing the SBA to “fine or order one-year imprisonment if officers or directors of the firms use their stock in an SBIC as collateral for a loan to buy additional stock in the same company.”).

241. Dilger & Gonzales, *supra* note 49, at 21 (For example, in 2003, the SBA’s OIG indicated, “an ongoing audit of SBIC oversight indicate[d] that policies and procedures in the Investment Division do not limit financial risk.”).

242. COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.’S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 47 (1991) (“The SBIC program is in a free fall of crisis proportions leading to extinction if immediate and effective changes aren’t made to its basis structure This crisis is the result of a combination of

ineffectiveness spurred public debate and raised questions about their persistence.²⁴³ Yet, the criticism has been systematically channeled toward ways to improve the program, rather than abolish it.²⁴⁴ Support for the program from the SBA and the congressional small business committees largely made this possible. While cognizant of the constant problems of the program, those agents continually stressed the importance of the program and offered ways for its improvement.²⁴⁵ For example, while stressing the fact that the number of financing each year offered by SBICs has been increasingly declining,²⁴⁶ the SBA in its report to the government proposed placing several regulatory limitations on the SBIC but continue its operations.²⁴⁷

When enacting the Small Business Investment Act in 1958, Congress sought "to provide an additional source of capital funds to small business concerns" envisioning "the establishment of a new industry composed of a privately owned corporations, which would stimulate and supplement the flow of equity capital and long-term loans to such small business concerns."²⁴⁸ Today, it is clear that thus far the SBIC program has not been effective in narrowing small business equity gap, which largely remains in

factors generally classified as deterioration in the asset quality of SBICs caused by factors both internal and external to the SBICs and what is a faulty basic program incentive structure.").

243. *Id.*

244. *See id.* at 5 ("The SBIC program is at strategic crossroads in its history. Currently there are regulatory and legislative proposals that would make major changes to the structure and operations of the program. Most of these proposals are a response to problems that have been identified during oversight hearings held during 1990 by the U.S. Senate's Committee on Small Business . . ."); *see also* H.R. Rep. No. 111-3854 (2009); H.R. Rep. No. 111-5554, at 9 (2010); Small Business Jobs Act of 2010, Pub. L. No. 111-240. All of these reports address various SBIC-related issues and the CRS report that discusses the SBA's recommendation to improve the SBIC program. Dilger & Gonzales, *supra* note 49.

245. *See* COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 5 (1991); *see also* *Small Business Committee Review the Problems of the SBIC Program yet Stressing its Significance: Hearing on Increasing Investment in Our Nation's Small Businesses Before H. Comm. on Small Bus.*, 110th Cong. (2007).

246. COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 11 (1991) ("the trend in the number of financings made each year by standards SBICs and SSBICS has been steadily falling.")

247. *Id.* at 88.

248. Small Business Investment Act of 1958, 15 U.S.C.S. § 633 (1958); *see also* SENATE SUBCOMM. ON INVESTIGATIONS AND GOV'T OPERATIONS, 90TH CONG., REP. ON INVESTIGATION INTO SMALL BUS. INV. CO. 45 (1968).

effect.²⁴⁹ A study analyzing the SBIC program's profitability between 1986 and 1991 characterized this period as one of very low profitability and very high failure rates that generated significant losses for the federal government.²⁵⁰ This study held that there was a “negative relationship between the extent to which SBICs used government-guaranteed funds and their economic performance” over the examined period.²⁵¹

Currently, the SBIC program is very small and has been declining, providing an insignificant number of new financing to small business.²⁵² At present, figure 2 demonstrates SBICs continue to be liquidated at a rapid pace, exposing the SBA to a higher risk per company. Others are choosing to exit from the program voluntarily.²⁵³

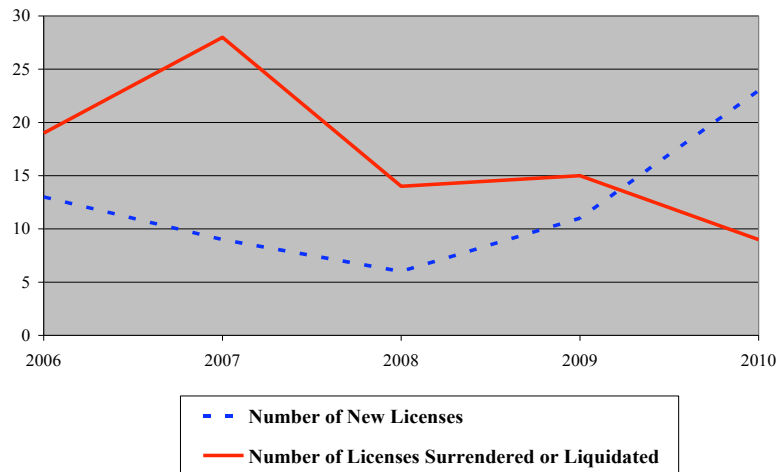
249. See Katherine Ryder, *The Wrong Fix for Small Business Lending*, FORTUNE, July 20, 2010, available at http://money.cnn.com/2010/07/20/news/economy/small_business_lending.fortune; Catherine Clifford, *Small Biz Lending Stimulus Runs Dry—again*, CNNMONEY.COM (Feb. 22, 2010), http://money.cnn.com/2010/02/22/smallbusiness/sba_recovery_loan_queue; Catherine Clifford, *SBA Lending Slips as Stimulus Cash Dries Up*, CNNMONEY.COM (July 9, 2010) http://money.cnn.com/2010/07/02/smallbusiness/small_business_sba_loans/index.htm; Emily Maltby, *Small Business Lending Drops 57%*, CNNMONEY.COM (Apr. 3, 2009) http://money.cnn.com/2009/04/02/smallbusiness/smallbiz_loans_drop.smb/; Catherine Clifford, *Small Biz Lending Freefall in Spotlight*, CNNMONEY.COM (Nov. 18, 2009) http://money.cnn.com/2009/11/17/smallbusiness/small_business_forum_geithner_sba/; Brian Krumm, *Understanding the New Tennessee Small Business Investment Company Credit Act: Stimulating Economic Growth At the Intersection of Free Market Capitalism and Government Intervention*, 11 TRANSACTIONS 93 (2010).

250. For example, of 280 SBICs sampled in 1986, 89 entered liquidation by the end of 1993 and 67 surrendered their licenses, leaving 123, or well under half, of the original sample. Elijah Brewer III, Hesna Genay, William E. Jackson III, & Paula R. Worthington, *A Trojan Horse or the Golden Fleece? Small Business Investment Companies and Government Guarantees* (Fed. Reserve Bank of Chicago Working Paper Series, Issues in Financial Regulation, Paper No. WP-97-22), available at http://www.chicagofed.org/digital_assets/publications/working_papers/1997/wp97_22.pdf; see also Senate Small Business Committee Report, *supra* note 235, at 17 (“By the end of 1991, almost 40% of the outstanding SBA leverage of the SBIC program was in a liquidation status . . . In 1991, SBICs of under \$5.0 million of assets are leaving the program rapidly with a drop of 45% during the past five years.”).

251. Brewer III, *supra* note 250, at 23.

252. In FY2011, there were 299 licensed SBICs in operation (143 debenture SBICs, 97 participating securities SBICs, 46 bank-owned/non-leveraged SBICs, and 13 SSBICs). The number of licensed SBICs has declined since FY2006: there were 369 licensed SBICs in FY2007, 348 in FY2008, 315 in FY2009, and 307 in FY2010. In FY2011, 203 SBICs provided at least one new financing to small business. See, Robert Jay Dilger, Congressional Research Service Report for Congress, *SBA Small Business Investment Company Program 12* (Feb. 2, 2012).

253. For example, in 2007, the SBA issued 9 new SBIC licenses and the number of SBIC licenses surrendered or transferred to liquidation was 28. *Id.*

Figure 2- SBIC License Activity 2006-2010

Source: Congressional Research Service²⁵⁴

Over the last half century, instead of narrowing the equity gap of small business funding, the growing demand for funding has increased.²⁵⁵ The funding ratio offered to small business concerns has decreased, with SBICs serving less than 0.2 percent of the small business population, a figure that has been dropping each year.²⁵⁶ There are many small businesses still struggling to find financing for their needs. When financing is found, the

254. *Id.*

255. *See, e.g.,* Edward C. Burks, *Patman Presses Inquiry on Loans*, N.Y. TIMES, Apr. 6, 1969 (quoting Congressman Wright Patman, then Chairman of the House Currency and Budget Committee, as saying on the House floor that “[i]t is no secret that lately the Small Business Administration has fallen far short of the goals and ideals under which it was established . . . the agency is without funds to make loans to small businessmen”).

256. In fact, “[t]he number of financings being provided to small business concerns fell almost 30% between 1989 and 1990.” COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.’S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 65 (1991). Between 1984 and 1990, the number of standard SBIC financings had been cut in half from about 2800 to 1300. *Id.* at 25. That number remained the same in 2004, when the SBIC program approved 192 loans out of total of 89,681 loan guarantees to small businesses. *See* SMALL BUS. ADMIN., REPORT OF APPROVED LOANS BY PROGRAM (2010), *available at* http://www.sba.gov/sites/default/files/files/WDS_ApprovalCount_Report.pdf. However, in 2009, the SBIC program provided less than 0.1% by approving 35 loans to small business out of 47,916 total loans. *Id.*

terms available are most often unsuitable to the needs of the small business concerns, and thus, many small firms settle for short-term loans or none at all.²⁵⁷ Recently, Representative Nydia Velázquez emphasized in different occasions on the House floor the current high demand for an institutional source of long-term loan and equity capital for small businesses:²⁵⁸

In previous recessions, the SBA has filled the gaps in private capital markets. Today, that is not the case. Loans funded by the SBA's flagship program have seen double digit declines, meaning, when we need the SBA to step in and help lift the capital markets, they are actually doing less.²⁵⁹

Credit standards are stricter, and small businesses are now looking not only to loans and to credit cards to finance their operations, but they are also looking to equity investment to turn their ideas into reality. This has become even more pronounced as asset values have declined, leaving entrepreneurs with less collateral to borrow against.²⁶⁰

Today, the inefficient path of the SBIC program continues.²⁶¹ Since its enactment in 1958, the Small Business Investment Act has undergone

257. See, e.g., COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 16 (1991). It is impossible to compare the number of small business loan applications rejected despite repeated attempts of the author to obtain this data from the SBA.

258. Generally, the number of loans granted by all SBA programs has been decreasing in the last five years. See *id.* For example, from a peak of 277,292 loans provided by all SBA programs in 2006, the number decreased to 124,360 in 2007, 93,541 in 2008, 69,765 in 2009 and 70,236 in 2010. *Id.*

259. Statement of Representative Nydia Velazquez, Committee Hearing on Laying the Groundwork For Economic Recovery: Expanding Small Business Access to Capital, Hearing Before the House Committee on Small Business, 111th Cong. 1st Sess., p. 1 (Jun. 10, 2009).

260. Representative Nydia Velazquez, Small Business Jobs and Credit Act of 2010, House Debate, 156 Cong. Rec. Daily, H4516 (June 16, 2010).

261. At some point, in addition to the "regular" SBICs licensed under section 301(c) of the Small Business Investment Act of 1958, Congress added a new type of Specialized Small Business Investment Company (SSBIC) meant to provide financing to small businesses whose "participation in the free enterprise system is hampered because of social or economic disadvantage." 26 U.S.C. § 301(d) (2006); see also Dilger & Gonzales, *supra* note 49, at 2. Yet, SSBICs were repealed at the end of the 1990s due to scandals that involved wealthy individuals using the SSBICs for private investments that did not involve minorities. See, e.g., *The Whitewater Scandal at Whitewater: A Primer*, WALL ST. J., Dec. 28, 1993, at A10 (noting that no new SSBIC licenses had been issued since October 1, 1996). The SBA's 8(a) Business Development Program replaced the SSBIC and continued to support and closely supervise business development for small and disadvantaged businesses. 13 C.F.R. §124 (2009); see

numerous revisions, almost one in each congressional session.²⁶² This is largely because of the support for the SBIC program from both the Select Small Business Committees and the SBA as a means of improving the well-being of small businesses, even when faced with reports of the inefficiency of the program.²⁶³ For instance, the SBA continues to provide positive feedback by calling for the liberalization of the SBIC program.²⁶⁴ Accordingly, the SBA promotes parallel liberalization plans in other organizations and agencies. On many occasions, the Small Business Committees proposed easing the compliance and tax burden on SBICs as a way to increase the flow of capital to small businesses from SBICs.²⁶⁵ At other times, the committees have urged Congress to grant small businesses

also COMM. ON SMALL BUS., 104th Cong., PROPOSALS TO STRENGTHEN THE SBIC PROGRAM (1995).

262. See generally, LEXIS search of Small Business Amendment Act of 1958, which provides for over 30 amendments to the act between 1970 and 2010.

263. For example, during the late 1980s the House and Senate Small Business Select committees promoted a proposal that expanded the long-term credit assistance for SBICs in the form of the proposed Corporation for Small Business Investment Charter Act (COSBI). *Corp. for Small Business Investment Charter Act*, H.R. 3392, 100th Cong. (1988); *Corp. for Small Business Investment Charter Act*, S. 2686, 98th Cong. (1984). Yet, lack of conclusive empirical data on the economic effects of federal credit assistance as well as political ideology postponed the launch of this proposed entity. JAMES M. BICKLEY, CONG. RESEARCH SERV. RL NUMBER, PROPOSED CORP. FOR SMALL BUS. INV. CHARTER ACT, PRO-CON ANALYSIS (1984). In 1994, the SBA established the SBIC Participating Securities Program (SBIC PSP) to encourage equity investments in the early stage of small business. Yet, in response to extensive losses and criticism over the SBIC program, in 2004 the SBA decided to close down the SBIC PCP program but kept and advocated for increased federal funding for the Debenture part of the SBIC program. See *Private Equity for Small Firms: The Importance of the Participating Securities Program: Hearing Before the H. Comm. on Small Bus.*, 109th Cong. 5 (2005).

264. See, e.g., *Legislation Updating and Improving the SBA's Investment and Surety Bond Programs: Full Committee Hearing Before the H. Comm. on Small Bus.*, 110th Cong. 1 (2007) (noting that the SBA reported on the SBIC program's problems and proposed to modify and simplify certain rules for the program).

265. Small business committees were instrumental in promoting legislation in Congress that eased the tax burden on small businesses and encouraged investment in these concerns. See, e.g., *Greater Federal Aid to Small Bus. Urged by House Unit*, WALL ST. J., Jan. 10, 1963, at 13. *Proposals to Strengthen the SBIC Program: Hearing before the S. Comm. on Small Bus.*, 104th Cong. 1 (1995) ("Within the SBIC program, specialized SBICs licensed to make investments only in minority-owned businesses have proven excessively costly to taxpayers for a variety of reasons, some relating to the program's structure and some relating to the business practices of certain SSBICs."); *The Impact of New Market Tax Credits, the SBIC Program, and 504 Program on Urban Communities: Full Comm. Field Hearing Before the H. Comm. on Small Bus.*, 110th Cong. (2007).

and SBICs more funding, and to consider legislation to encourage small business investments.²⁶⁶

Moreover, banking institutions, which used to play a significant role in the SBIC program, are rapidly leaving it. The era of big bank-owned and operated SBICs is over.²⁶⁷ Until the passage of the Gramm-Leach-Bliley Act in 1999, the only way a bank could operate a venture capital or private equity fund was by obtaining an SBIC license.²⁶⁸ Therefore, banks were key partners of SBIC program and had a significant positive impact on the performance of the program. For example, in the 1990s bank-owned SBICs provided 61% of the total loans and investments, 74% of the total cash and idle funds, and 75% of the disbursements to small concerns.²⁶⁹ However, with the passage of the act, banks are now permitted to operate private equity subsidiaries without obtaining and maintaining SBIC licenses. As a result, currently, only 15% of all SBICs are bank-owned and less than 5% of dollars now invested by all SBICs is attributable to bank-owned and operated SBICs.²⁷⁰

After half a century, it seems we are locked in in a program that does not fulfill its mission of closing the lending gap to small and pioneering firms. But our legal system is filled with rules and regulations governing small businesses, and so we remain invested in an inefficient path; seemingly remaking it would involve high negative externalities.²⁷¹ In the meantime,

266. See, e.g., *Senate Unit Asks Change in Small Business Investment Program to Make It a Success*, WALL ST. J., Apr. 27, 1960, at 6; *Increasing Investment in our Nation's Small Businesses: Full Comm. Hearing Before the H. Comm. on Small Bus.*, 110th Cong. 11–28 (2007) (statement of Stephen Vivian, National Association of Small Business Investment Companies); *Legislation Updating and Improving the SBA's Investment and Surety Bond Programs: Full Comm. Hearing Before the H. Comm. on Small Bus.*, 110th Cong. (2007).

267. *Increasing Investment in our Nation's Small Businesses: Full Comm. Hearing Before the H. Comm. on Small Bus.*, 110th Cong. 51 (2007) (statement of Stephen Vivian, National Association of Small Business Investment Companies).

268. *Id.*

269. COMM. ON SMALL BUS., THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES, S. REP. NO. 102-44, at 8, 17 (1991). Additionally, due to the high regulatory supervision on such financial institutions, the risk of bank-owned SBICs failures remained lower than non-Bank owned SBICs.

270. Dilger & Gonzales, *supra* note 49, at 10.

271. For a similar notion, see, e.g., Douglas Holtz-Eakin, *Should Small Businesses Be Tax-Favored?*, 48 NAT'L TAX J. 387 (1995) (asserting generally it is difficult to construct a case in favor of systematically favoring small businesses, especially through the tax code); Ronald F. Wilson, *Federal Tax Policy: The Political Influence of American Small Business*, 37 S. TEX. L. REV. 15, 28 (1996) (estimating that the cost of annually subsidizing small business is \$5 billion); Eric Toder, *Does the Federal Income Tax Favor Small Business?*, NAT'L TAX ASSOC. PROCEEDINGS OF THE 100TH ANNUAL CONFERENCE 1, 4 (2007),

the government is continuing to waste time and money sustaining a failed small business program.

VI. CONCLUSION

The causes of events are ever more interesting than the events themselves. – *Cicero*²⁷²

Large and small firms have different funding options.²⁷³ Because they are perceived as risky ventures, small firms have trouble obtaining capital to finance new equipment or to expand inventories.²⁷⁴ While larger firms can raise capital through retained earnings or issuance of new securities, smaller firms cannot issue new stock easily and usually do not have much retained earnings. Congress sought to narrow that gap of small business funding by establishing loan guarantees and special preferences, such as the SBIC program.

One of the fundamental conditions to generate social change is critical thinking about the choices made in the past.²⁷⁵ In the case of government's

<http://www.urban.org/url.cfm?ID=411606> (arguing against the federal income tax favoring firms of different sizes).

272. MARCUS TULIUS CICERO, EPISTOLAE AD ATTICUM, Book IX, Section 5, in CARL C. GAITHER & ALMA E. CAVAZOS-GAITHER, STATISTICALLY SPEAKING: A DICTIONARY OF QUOTATIONS 20 (1996).

273. Richard J. Judd & Barbra K. Sanders, *Regulation, Small Business, and Economic Development: A Historical Perspective on Regulation of Business*, in RICHARD J. JUDD, WILLIAM T. GREENWOOD, & FRED W. BECKER, SMALL BUS. IN A REGULATED ECONOMY—ISSUES AND POLICY IMPLICATIONS 223 (1990).

274. See, e.g., *Relief for Small Firms Urged by Witnesses*, WALL ST. J., Jan. 8, 1958, at 9 (discussing the Curtis Bill proposed to expand funding for small business and Congress to encourage the reinvestment of earned income); Thomas Petzinger, Jr., *Closed Doors*, WALL ST. J., Jan. 22, 1980, at 1; Sanford L. Jacobs, *Reagan Group Suggests Ending Programs Favoring Small Firms*, WALL ST. J., Jan 12, 1981, at 23.

275. “If a society cannot think effectively about the alternative path because it lacks the vocabulary, concepts, or even belief that the other path could exist, then that society cannot consciously choose either to return to the branch point of the two paths (and then go down the other path) or to jump to the other path.” Hathaway, *supra* note 24, at 651. Stephen J. Margolis & S.J. Leibowitz, *Path Dependence*, in NEW PALGRAVE DICTIONARY OF LAW & ECONOMICS 17 (Peter Newman ed., 1998). Yet, scholars have clarified that “path dependence does not simply mean that history matters, but rather that once an institution has taken a path, the costs of reversal may be very high, so that earlier plausible options (like the inquisitorial system) are now excluded.” Page, *supra* note 31, at 87 (criticizing the over-application of the idea of path dependence to almost any process, which caused this concept to dull in value by

relations with small businesses, it is useful to look back in history to a “critical juncture” by which Congress acknowledged the need not only to protect small concerns from the concentration of economic power but vigorously promote small businesses.²⁷⁶

Small business culture developed from our nation's philosophy of separation of powers, one of the bases of our democracy. Throughout history, suspicions about the concentration of power brought the government to favor small firms, viewing them as guardians of fair competition and free society. Natural disasters and economic shocks aggravated the inherent tight credit problem of small business and reinforced preconceived notions that small businesses had to be salvaged whenever events out of the government's control harmed their well-being. This tendency brought government to expand its patronage over the years by providing small firms with special preferences through the legal system. Since most minority businesses are small businesses, their advancement was another form of affirmative action.²⁷⁷

Once a small business culture developed, corresponding small business political incumbents expanded path dependency of small business programs.²⁷⁸ Small business agencies and entities were established to promote another type of growing power—the power of the small business organizations. Congress formed congressional small business committees and the SBA to look at small businesses' problems and reduce their equity gap. Consequently, the SBA provided direct loans and created a unique partnership between the private and the public sector to provide venture capital and long-term equity financing—the SBIC program.²⁷⁹ Yet, the program soon turned out to be inefficient and cumbersome, and led to losses for the government and private investors.

Recently, scholars have been arguing that the case for small business favoritism is ambiguous when one looks at the transaction costs and the

noting that “in becoming a trendy way to say that history matters, path dependence no longer provides any analytic leverage”).

276. CHRISTOPHER DWYER, *KNOW YOUR GOVERNMENT—THE SMALL BUSINESS ADMINISTRATION* 21 (1991).

277. David B. Longbrake & Woodrow W. Nicholas, Jr., *A Geographic Structure for Black Small Business Research*, in *SMALL BUSINESS IN A REGULATED ECONOMY—ISSUES AND POLICY IMPLICATIONS* 187 (Richard J. Judd et al. eds., 1990).

278. Page, *supra* note 31 at 88.

279. COMM. ON SMALL BUS., *THE SMALL BUS. ADMIN.'S SMALL BUS. INV. CO. PROGRAM: A REVIEW OF SELECTED ISSUES*, S. REP. NO. 102-44, at 4 (1991).

cumulative effects of regulation.²⁸⁰ The experience of the last half decade shows the SBIC program did not provide benefits exceeding its costs. If one is to look at the performance of the SBIC program and consider alternative routes, one might discover a more efficient solution to the equity problem of small business. Yet, as this paper reveals, Congress's early funding policy became locked-in and resistant to change through self-reinforcement of organizations such as the SBA and congressional committees and expansion of positive feedbacks of growing small business culture.

The question of why our legal system maintained this inefficient program over a century is important to explore. Likewise, the intuitive concept that small is beautiful (when it comes to business) needs to be examined through the prism of social history and the path dependence paradigm. Rhetoric and the desire of legislators to appeal to their constituents are over-simplistic explanations for the abundance of small business preferences.²⁸¹ This article aimed at providing a more comprehensive framework to explain the long-time existence of failed small business programs. By utilizing path dependence theory in the political prism, the article proved that self-reinforcing small business organizations and the development of positive feedbacks through small business culture contributed to the persistence of an inefficient program such as the SBIC.

Our legal system is locked in an inefficient rut. Congress has invested extensive resources in the SBIC rut, and created rules and regulations to encourage others to follow that rut. Although it may seem that the costs of diverging from the current program seem too high,²⁸² breaking the inefficient SBIC path can only be achieved by radical reform led by courageous

280. Steven Bradford, *Does Size Matter? An Economic Analysis of Small Business Exemptions From Regulation*, 8 J. SMALL & EMERGING BUS. L. 1 (2004) (arguing against granting special regulatory exemption for small businesses from securities regulations); WILLIAM A. BROCK & DAVID S. EVANS, *THE ECONOMICS OF SMALL BUSINESS: THEIR ROLE AND REGULATION IN THE U.S. ECONOMY* (1986).

281. David A. Super, *The New Moralizers: Transforming the Conservative Legal Agenda*, 104 COLUM. L. REV. 2032, 2096 (2004) (stating that the new moralizers have suggested that their budget-busting tax cuts benefit another group widely regarded as suffering from innocent misfortune: small-business people); see also Richard S. Whitt, *Adaptive Policymaking: Evolving and Applying Emergent Solutions for U.S. Communications Policy*, 61 FED. COMM. L.J. 483, 590 (2008) (arguing that while small business gets lip service politically, government programs often fail to match the rhetoric); Stacy Sulman Kahana, *Crossing the Border of Plenary Power: The Viability of an Equal Protection Challenge to Title IV of the Welfare Law*, 39 ARIZ. L. REV. 1421, 1439 (1997) ("The Court need not accept Congress' rhetoric as fact.").

282. Page, *supra* note 31, at 88; Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 645-46 (1996).

legislators.²⁸³ An alternative to the current SBIC program is to return to the initial proposal of instituting private local bank lending to increase the supply of capital available to small businesses.²⁸⁴ Banks and institutional investors tend to have specialized knowledge about particular industries and are better suited to monitor and assist small businesses. And the Federal Reserve System is much more equipped with supervising, licensing and auditing capabilities to administer investment institutions such as SBICs than the SBA.²⁸⁵ Since the current SBIC experience of combined market capitalism and government intervention has been unproductive, there is a need to find a more efficient route such as shifting to private institutional banking system.

The purpose of this article was to spur a rethinking of the road we have taken in the last century. Policymakers should be aware of the path dependencies in our legal system and consider whether alternative, different paths would be more efficient and effective.²⁸⁶ Our government is constantly considering proposals to simplify the legal system.²⁸⁷ The SBIC is an example of a small business program that has not fulfilled its purpose and should be replaced or at least redesigned to better achieve its goals. It is also time to rethink the focus on size in the U.S. legal system and the contribution of small business to the economy as it is not certain that the goose has indeed laid the promised golden eggs.²⁸⁸

283. Due to the high political value of small business, no one would like to be viewed as going against the “little guy” or the “Main Streets across America”. See, Press Release, U.S. Senate Committee on Small Business & Entrepreneurship, *supra* note 3 (statement of Sen. Patty Murray (D-WA)).

284. See *supra* notes 187–191 and accompanying texts.

285. *Id.*

286. Pierce, *supra* note 50, at 563.

287. For example, in March 2009, the Obama Administration announced the formation of a task force led by former Federal Reserve Chairman Paul Volcker as part of the President’s Economic Recovery Advisory Board. The task force was charged with proposing ways to simplify the tax code, reduce evasion, close loopholes and reduce the tax gap. *How the Complexity of the Tax Code Hinders Small Businesses: Hearing Before the H. Small Bus. Subcommittee on Finance and Tax (2009)* (testimony of Keith Hall, National Tax Advisor). The task force received more than 500 submissions of serious tax reform ideas and decided to delay its report and hold various public meetings. Statement from PERAB Chairman Paul Volcker on Tax Task Force (November 27, 2009), available at <http://www.whitehouse.gov/blog/2009/11/27/perab-tax-task-force>.

288. See generally Mirit Eyal-Cohen, *Down-sizing the “Little Guy” Myth in Legal Definitions*, 98 IOWA L. REV. (forthcoming 2013) (arguing that small business definitions are inconsistent, overinclusive, and do not fulfill their legislative intent).