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Business Regulation vs. Growth: The View from Middle America

By Warren Stephens

If we ever expect to restart the American economy, we need to focus our attention on the forgotten middle -- that is, "middle market" private and public companies, which are the true growth engines of our economy. There are more than 100,000 of these enterprises, each with annual revenues between \$25 million and \$1 billion. They deliver 40% of our gross domestic product and employ 32 million people, more than the 500 largest U.S. corporations combined, according to U.S. Census data. And several of today's midsize enterprises will be tomorrow's Fortune 500 companies.

As the CEO of an investment bank based in Middle America and specializing in the middle market, I speak regularly with the leaders of midsize companies. Many of them talk about the uncertain regulatory and tax environment we are in as a deterrent to growth. I will try to give you a few examples of what they say.

Most middle market CEOs literally cannot keep up with the changes in regulation and the behavior of the regulators. For example, they are scratching their collective heads as they watch the National Labor Relations Board (NLRB) challenge whether Boeing violated labor laws by putting a plant in South Carolina to assemble its 787 Dreamliner. The concern is whether this an indication of future action the NLRB may take against middle market companies that have far fewer resources than Boeing to fight back.

Then there is health care. At this point, assuming President Obama's health-care reform begins to go into effect in 2013 -- scarcely a year and a half away -- no one knows for certain its impact on his or her company. That is a very unsettling unknown as CEOs try to plan their budgets.

Finally, the regulations and rules that will emerge from the Dodd-Frank financial reform inject great uncertainty as to the availability of credit for middle market companies. Banks don't know, for example, the capital requirements that will be required to support certain types of lending activity. This puts a chill on the banks and, of course, on the companies to which they lend. The Consumer Finance Protection Bureau has restricted -- and will further restrict in the future, I believe -- credit availability to people on the lower end of the credit rankings. Without access to properly priced loans, these people will not be able to buy the goods they need and want. This lack of credit will further depress demand and production.

Here are five simple legislative changes whose cumulative impact would dramatically improve the operating environment for midsize companies and set the stage for economic growth:

-- Regulatory agencies should be required to study the costs and economic impact, including on job creation, of their rule-making before any rules take effect. Legislation to accomplish this goal has been introduced by Sen. Rob Portman (R., Ohio). His amendments to the Economic Development Revitalization Act of 2011 require regulations by independent agencies such as the Securities and Exchange Commission to be subject to the Unfunded Mandates Reform Act of 1995, which forced executive branch agencies (such as the Environmental Protection Agency) to identify the costs of their regulations.

-- The Regulations from the Executive in Need of Scrutiny Act (Reins) introduced by Rep. Geoff Davis (R., Ky.) would require that any proposed rule with an annual economic impact of \$100 million or more be sent to Congress for approval. The Office of Management and Budget (OMB) has estimated that since 1980 federal regulators have written more than 130,000 rules. More than 1,000 of these rules have cost businesses in excess of \$100 million just to comply, according to the American Enterprise Institute's Nick Schulz. The OMB estimates that federal regulation costs the economy over \$1.75 trillion each year.

-- Sen. Mark Warner (D., Va.) has been seeking support for a bill that would require regulators to drop one current rule for each new one adopted. Dubbed the "Pay-As-You-Go Plan," Mr. Warner's proposal would offer a solution to regulatory creep, in which new red tape is routinely wrapped by a federal agency around a new rule, creating confusion among American businesses while rewarding bureaucratic ineptitude.

-- Tax loopholes should not be confused with smart tax policy that offers incentives for innovation by middle market companies. A permanent Research and Experimentation tax credit is an example of a smart tax initiative that rewards a business that is willing to try something different.

-- Initial public offerings have proven to be a successful vehicle in this country for capital formation. The tepid rebound of our economy can be attributed in part to the lack of IPOs. In conversations with other CEOs, it's become clear to me that the Sarbanes-Oxley Act has been a real deterrent to companies that would like to go public.

Indeed, I have had numerous conversations with CEOs of public companies that are actively considering becoming private, and their primary reason is the excessive regulation and compliance that are required of public companies. When Sarbanes-Oxley was enacted in 2002, the Securities and Exchange Commission estimated the annual cost of compliance would average \$91,000 per company. Various surveys have shown that, depending on a company's size, annual compliance costs are actually in the millions.

Let's substitute ideological arguments with straight talk and commonsense solutions to unshackle investment. By designing a set of policy solutions that eliminate obstacles, remove disincentives and reward smart risk-taking by middle market companies, we can reignite our economy and create the kinds of jobs that built this great country.

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