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THE DEFINITION OF THE SMALL BUSINESS

THEORY, MECHANICS AND PRACTICE

A comparative study of the Laws
of the UK, USA, Israel and
the People's Republic of China

LEAH HERTZ
PhD Thesis

[redacted]

THE CITY UNIVERSITY

BUSINESS SCHOOL

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Leah Hertz

DECLARATION

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ABSTRACT

This study of the Legal Definition of the Small Business set out to ascertain whether a unitary universal definition of small business existed and, if it found none, to formulate it. A legal definition, which is only one of the definitional forms used to define phenomena, has to be viewed in the general context of definitions, their functions, participants and methods of formulation; and has to be compared with other non-legal definitions of the same phenomenon, if the quest for a legal definition of small business is to be justified. If in addition the legal definition is to be a unitary definition of small business, the various legislation that defines small business have to be studied, compared and evaluated before such a legal definition can be formulated.

It is for these reasons that the present study found it necessary to formulate a general theory of definition; and also to focus on economic, sociological and psychological definitions of small business, in addition to its juristic definitions. For a legal definition to be accepted as a unitary universal definition of a phenomenon, it has to be compatible with the existing legal philosophies of the different countries. To ensure the widest possible application of such a proposed definition, it was chosen to study and compare the small business definitions of legal systems that represented economies of widely different philosophies and sizes: the USA, the UK, the People's Republic of China and Israel.

The classification of these definitions was undertaken in accordance with the criteria that constituted them and in accordance with their method of formulation. Alt hough this classification has indicated much inconsistency in the definition of small businesses, not only between different countries but also within the same country and the same legislation, it has also indicated that small business is one of the few common denominators between the different legal systems of the different economic philosophies, and as such it has a definite need for a unitary universal definition.

ABBREVIATIONS

CA	Civil Appeal (Israel)
Cir	Circuit (USA)
CFR	Code of Federal Register (USA)
DMI	Dinai Medinat Israel) (Laws of the State of Israel)(Israel)
F	Federal Reporter (USA)
F.2d	Federal Reporter (Second Series) (USA)
FR	Federal Regulations (USA)
HC	"BAGATZ" High Court of Justice (Equity) (Israel)
HR	House of Representatives (USA)
H.Res.	House of Representatives Resolution (USA)
IL	Israeli Lira (currency) (Israel)
ISSB	International Symposium of Small Businesses
ITA	Income Tax Appeal (Israel)
L.Ed.	Lawyers Edition (USA)
ND	Northern District (USA)
NE	North Eastern Reports (USA)
PD	"Piskai Din" (cases) (Israel)
PE	"Pesakim Elyonim" (High Court cases) (Israel)
PL	Public Law (USA)
PLR	Palestine Law Reports (Israel)
PM	"Pesakim Mehoziym" (District Court cases) (Israel)
PRC	Peoples Republic of China
QT	"Qovetz Hatakanot" Code of Regulations (Israel)
SBA	Small Business Administration (USA)
S.Ct.	Supreme Court Reports (USA)
SFES	Small Firms Employment Subsidy (UK)
SH	"Sefer Hahukeem" (Code of Statutes) (Israel)
TC	Tax Cases (USA)
US	United States Reports (USA)
USC	United States Code
USCA	United States Code Annotated
WD	Western District (USA)
YP	"Yoman Hapeersumim"(the Official Publication) (Israel)
YR	"Yton Rasmi" (the Official Gazette) (Israel)

LEGISLATION

USA

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PART ONE

THEORY

CHAPTER ONE

INTRODUCTION: THE REASONS FOR THE RESEARCH, THE METHOD, AND THE STRUCTURE

(i) A Phenomenon Without a Definition

The small business is one of those phenomena which, though existing everywhere and frequently in the public eye, mean different things to different people in different places. Any such subject that provokes variations of meaning and interpretation is one in need of clarification and therefore worthwhile researching.

This thesis is therefore concerned with the study and classification of the existing definitions and meanings attributed to small businesses in the USA, the People's Republic of China, the UK and Israel. The basis for classification is the common criteria of the various definitions, and its aim is to gain an insight into, and an understanding of, the reasons responsible for the existence of such variances between the definition of small businesses, not merely between countries but also within them. The overall purpose is to use the gained knowledge and understanding for the formulation of a uniform, universally accepted definition of the small business.

Though the lack of a unitary definition of small business has been acknowledged, its formulation was not considered a priority, in fact, it was looked upon as an irrelevancy. It was deemed irrelevant because the non-existence of a definition, or the discord between definitions, does not affect the existence of that phenomenon and/or its mode of operation.

The phenomenon of the small business is not the only one without a definition. The universe abounds with phenomena which have never been defined, either through ignorance of their existence, or because of insufficient data about them. On a universal scale, the phenomenon of the small business might not be in the most urgent need of a definition, still the

formulation of its definition will mean an additional phenomenon that has been explained.

Though the definition of the small business caters only for a specific sector of the economy, it is hoped that the general principles of definition, which have been expounded in the "Theory" part, would serve as a general guideline for those who would set out to define other phenomena.

(ii) A Definition is a Practical Need

The formulation of definitions is viewed as being primarily of academic interest, rather than having a practical application, yet the latter is the present vogue in academic circles. And as the small business is fundamentally a mundane phenomenon, it is believed that its practical aspects, such as management techniques, financial resources and marketing problems, are those in need of more urgent attention than the semantics of definitions. The preference for practical subjects can be attributed to the notion that these can resolve imminent problems, whereas the impractical ones, though they might evolve long term benefits, are of negligible importance for the present. As practical phenomena exist chiefly in the present, rather than in the past or future, the importance of a small business definition is dismissed.

This is a myopic approach, because a phenomenon without an exclusive definition is a non-existent phenomenon, not just from the juridical aspect, but also from the factual one, because its definition means its identification as a unique occurrence dissimilar to others. A non-existent phenomenon cannot ask or expect preferential treatment, which is, after all, what the small business is struggling to achieve. The lack of consequential legislation regarding the small business can to a large extent be attributed to the absence of an accepted universal or national definition. It is therefore sheer shortsightedness on behalf of those who dismiss the importance and urgency of a small business definition, on account of more pressing practical issues. Hence, the formulation of a unitary definition of small business is not just

an academic pursuit, but is of major importance to the existence and prosperity of this economic sector, which needs institutional and governmental support that cannot be easily forwarded without defining those in need of it.

(iii) Why a Legal Definition?

A phenomenon such as small business, which is concerned with practical issues, can benefit only from a definition that leads to practical consequences. Only a definition that could be incorporated within legislation, could fulfil this task. Any other type of definition such as economic, sociological or psychological, would no doubt increase the knowledge about small businesses, but not their benefits.

The uniqueness of a legal definition is that it has to fit into a system of law which is based not just on logic, but also on practical considerations. The formulation of a legal definition cannot therefore be a mere logical exercise of matching conclusions to findings and data, without the use of discretion as to the practical aspects of the consequences involved.

In stating that the law is not a purely logical construction, it is not meant to detract from the merits of this discipline. On the contrary, it is to say that legal thinking necessitates more refined thinking faculties than the straightforward ones employed by the logical process.

A quotation from the learned English jurist Cheshire is introduced to support this view:

> "Private international law is no more an exact science than is any other part of the law of England; it is not scientifically founded upon the reasoning of jurists, but it is beaten on the anvil of experience."[1]

A similar view was expressed by the learned American jurist Lorenzen, who said that Anglo-American tribunals have always attempted to reach a just decision in accordance with their conceptions of utility and justice.[2]

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1 P.M. North (ed.), Cheshire's Private International Law, Butterworths, ninth edition, 1974, p.32.

2 E.G. Lorenzen, 33 Yale L.J., 1924, p.736.

The "legal thinking" has been emphasised, because it is intended that the legal definition of the small business will become part of the general legal structure, and therefore it ought to conform to the thinking moulds that characterise this discipline.

(iv) Definition – by Comparison

When the subject for definition is a multiple phenomenon such as small business, it is necessary to evaluate and compare several such similar phenomena in order to establish their common characteristics. It would thus seem that all definitions of multiple phenomena are arrived at by a process of comparison. In the present situation it is not the actual small businesses that are being compared, but the various definitions attributed to them.

The underlying aim of any comparison is to find similarities rather than differences, common denominators rather than differentiators, because differences are an inherent feature of phenomena. It is easy to find dissimilarities because, where human elements are concerned, no one phenomenon is an exact replica of another, and the small business, unlike a scientific phenomenon, is a composite of human factors. Consequently, it is an accepted practice to compare similar phenomena in similar surroundings, as this enhances the prospects of discovering their common characteristics. Likewise, it is believed that maximum benefit can be extracted from the study of similarities, as the ensuing conclusions can be adopted in a practical manner, frequently benefiting the compared phenomena on a cross-fertilisation principle.

But there exists another approach: that of comparing dissimilarities. The reasoning behind this is that only by creating a fusion between seemingly contrasting phenomena can a new concept emerge. It is suggested that such a fusion is called for in order to amalgamate the numerous small business definitions into a unitary one. Thus, it is the comparison of dissimilarities that has been adopted, rather than the more conventional method of

comparing similarities. The dissimilarities of the compared small businesses are expressed chiefly in the different economic regimes that host them, rather than in their intrinsic different characteristics or modes of operation.

(v) The Choice of Countries for the Comparison

In order to create the ideal setting for the comparison of the legal definitions of small businesses in different legal economic regimes, the following countries were chosen: the USA, the People's Republic of China, the UK and Israel. The USA and the People's Republic of China, provide the polarities, and the UK and Israel the bridges; the UK the western connection and Israel the eastern one.

Because a country's economic system cannot be divorced from its legal one - as invariably the former has to be sanctioned by the latter - the choice of countries with different economic systems means also different legislative approaches. This choice of countries was expected to achieve a comprehensive sampling of the small business definitions of countries that function along the world economic/legal axis: from the eastern pole of communism to the western one of capitalism.

At the eastern pole is found the People's Republic of China, which represents the communist/totalitarian economic legal system, where private enterprise and ownership have until recently been taboo.

Its connecting bridge with the western economic/legal systems leads through Israel, which represents a mixed economic system based on private and socialist enterprises under the hegemony of a socialist/democratic legal system, in which the legislation is carried out by a democratically elected parliament, but is orientated towards socialist, rather than capitalist principles. The socialist sector of the Israeli economy is represented by its kibbutzim and co-operatives, whose proportional share of the economic output is high. Small businesses are a large part of the socialist and private sector

there, in particular as a result of the overall small size of the economy.

In closer proximity to the western pole of the axis lies the UK which represents the mixed economy system, in which large and heavy industries such as steel, coal, petrol, electricity and transport are nationalised, while the lighter ones are privately owned. Its legal basis has been democratic at all times, but the economic leanings, whether towards socialism or capitalism, depend on the political climate of the time. Until the present government of Mrs Thatcher, small businesses have existed there rather more out of tolerance than out of conviction.

At the opposite extreme to the People's Republic of China, at the western pole, is the USA which represents the capitalist economic system, duly sanctioned by a supportive legal system. Usually, capitalism is associated with private ownership, irrespective of whether the size of the ownership is small or large. If, however, a relationship with size could be established, then it would be established with big businesses rather than with small ones, because the freedom of ownership enjoyed under a capitalist economic/legal system would eventually lead to the accumulation of larger ownerships by fewer owners. That the USA, the citadel of capitalism, has taken an extraordinary interest in the preservation and promotion of small business is not a direct correlation with capitalist philosophy, but is unique to the country's belief that the survival of the "small man" is essential to the well-being of the nation.

Though the economic and legal systems of these four countries are different, especially those of the USA and the People's Republic of China, they have at least one known factor in common: small businesses. All of them, some to a lesser extent than others, host a small business population, whose survival and progress they all aim to maintain.

(vi) The Structure

The thesis consists of four parts: Theory, Mechanics, Practice, and The Definition.

Theory

In the usual course of events, actions precede their explanations and definitions their theories. Consequently the explanations and theories are made to fit the unalterable deed or statement. These cannot be counted as explanations or theories, but are mere excuses and justifications. If it is aimed to reach an objective definition, one that is unmarred by the established facts which, because they cannot be changed, have to be accommodated, then the theory ought to be formulated prior to, and independent of, the emerging definition.

The formulation of a small business definition is not different from that of any other definition, whereby the phenomenon has to be matched with the most suitable type of definition. It is for this reason that the "theory" of the definition deals with the types of definitions practiced, the methods and techniques used in their formulation and the types of criteria they employ.

Without such a theoretical base to classify and evaluate findings, a universally unitary definition of a heterogenous phenomenon like the small business could not be formulated. And as no such theoretical framework has been encountered, it had to be constructed.

Mechanics

While the "theory" provides numerous options of types and methods of definitions to choose from, the "mechanics" adopts some of them for a specific phenomenon, and constructs the prototype "model", which is required before any mass application can commence. The introduction of these "models" into operation is then entrusted to the "practice".

A noted characteristic of any "model" is that it is not available to the wider public of users. Similarly, the "mechanics" part deals with those definitions of small business which, for various reasons, were not used by the small business itself, and therefore had no direct effect on its success or failure.

For a definition to be effective, it has to be included into a legislative system and should be based on easily verifiable criteria, namely, quantitative ones. The mere incorporation of a definition into legislation is not sufficient to render it effective, because if it is based only on qualitative criteria, it is not verifiable despite its legal pedigree. As regards definitions outside the legislative system, these are of no practical use to the small business, even if they are based on quantitative criteria, because they lack the enforce ment machinery of the legal system.

Practice

The main task of the part dealing with "practice" is to survey, assess and classify the legislations that differentiate between types of enterprises. This is done in three ways:

1. by surveying the criteria and numerical determinants which were used in that process of differentiation;
2. by ascertaining if the differentiation was done in order to define a small business, or for any other reason;
3. by comparing the various legislations of each country within the exclusivity of its own legal system, as well as with those of the other countries under research.

Definition

The "definition" part consists of the deductions arrived at as a result of this study, and the definitions of "business" and "small business". Though the thesis is concerned only with small business, and not with the wider subject of business, the study has indicated the existence of an inter-dependency between these phenomena, which has therefore necessitated the definition of "business" before that of "small business" could be attended to.

CHAPTER TWO

THE FUNCTION OF A SMALL BUSINESS DEFINITION

Introduction

Small businesses, small firms, small concerns or small enterprises have not been officially recognised as generic names, but are considered to be a sub-group or a division within the wider definition of a business, a firm, a concern or an enterprise. The Oxford Dictionary[1] defines them as follows: business - "a commercial enterprise as a going concern"; concern - "a business or firm"; firm - "a style or name under which a commercial house transacts business", and an enterprise - "a bold, arduous, or dangerous undertaking." Jowitt's Dictionary of English Law[2] offers definitions only for "business" and "firm". It describes business as: "a wider term than trade", and considers farming or keeping a school to be a business and not a "trade". Its definition of a firm is as follows: "Firm denotes the style or title under which one or several persons carry on business... a firm is by laymen considered as a kind of corporation." Neither the Oxford Dictionary nor Jowitt's Law Dictionary offers a definition of a small business, a small concern, a small firm or a small enterprise.

The initial introduction of the small business concept into the United Kingdom economic terminology can be traced to the Report of the Macmillan Committee on Finance and Industry[3] published in 1931, in which the lack of long-term capital for small and medium-sized firms was recognised.

> "It has been represented to us that great difficulty is experienced by the smaller and medium-sized businesses in raising the capital which they may from time to time require, even when the security offered is perfectly sound."

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1 The Shorter Oxford English Dictionary, 1977.

2 John Burke (ed.), Jowitt's Dictionary of English Law, Sweet & Maxwell Ltd., second edition 1977.

3 Report of the Committee on Finance and Industry, Cmnd.3897.

In the 1930s, as a result of the Macmillan Report, a number of investment companies specialising in the financing of small businesses were established.[4] The most important were Charterhouse Industrial Development, Credit for Industry and Leadenhall Securities. Though the assistance these institutions offered to small businesses was considerable, their resources were limited and the volume of business done by them was correspondingly small.[5]

During the war years of 1939-1945 it was decided that the post-war restructuring of industry would require the channelling of resources to the rebuilding of small and medium-sized enterprises. In 1945 the clearing and Scottish banks, supported by the Bank of England, created the Industrial and Commercial Finance Corporation Ltd. (ICFC) for the purpose of providing long term capital to small firms, and in 1959 the Radcliffe Committee recommended some improvement of the financial facilities available to small firms.[6] In neither of these reports, the Macmillan or the Radcliffe, have the committees attempted to define the small business they were referring to in their recommendations.

The first attempt to define the phenomenon as a unique one, and not as a sub-group of "business", was undertaken by the Bolton Committee in 1971.[7] Since then, the term has been recognised as a generic name for a type of business different to a large one. This however has not resulted in a uniform definition, and the present situation is that the Bolton definition, though acknowledged, used and referred to, has not been officially adopted.

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4 Ibid., para.404.

5 James Bates, The Financing of Small Business, Sweet & Maxwell Ltd., 1964. Norman Macrae, The London Capital Market, Staples, 1957.

6 Report of the Committee on the Working of Monetary System, Cmnd.827.

7 J. E. Bolton, Small Firms Report of The Committee of Inquiry on Small Firms, HMSO, 1971, Cmnd.4811.

In the USA, it has been accepted that small businesses are a section of the business community which owing to their unique characteristics, merit special considerations. The first to give specific attention to small businesses was the Reconstruction Finance Corporation, which was set up as a result of the Great Depression.[8] This was followed by the Smaller War Plants Corporation, which was established in 1942; the Office of Small Business in the Department of Commerce, in 1946; and the Small Defence Plants Administration which was set up in 1951.

Concern for small business has been characteristic of American politics, in which there is a fear of the centralisation of economic power, which is identified as political power. In 1890 the USA Congress passed the **Sherman Anti-Trust Act,** and in 1914 the **Clayton Act.** Both Acts were concerned with the preservation of small businesses. More recently Congress has introduced "fair trade laws", notably **The Robinson Patman Act 1936,** and favoured small business on some federal purchases and sales of goods and services.

The formation of these agencies, and the introduction of the mentioned legislation, indicate that the USA has recognised the special status of small businesses. But, despite this, no unitary definition has been agreed upon. The first official legal definition appeared in the **Selective Service Act 1948,** followed by the **Small Business Act (as amended) 1953.** Apart from these definitions there exist others, which although they do not relate directly to small businesses, do imply it.

In Israel,[9] where some 90% of the businesses would be considered small or medium if judged according to the USA criteria, the administration has recognised that the local small businesses constituted a separate sector within the economy. The Ministry of Commerce and Industry has a division

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8 Addison W. Parris, The Small Business Administration, Frederick A. Praeger, Washington, 1968, pp.i-viii.

9 Moshe Peled, Small Industry in Israel, The Israeli Small Business Advisory Centre, 1967.

responsible for small industry and co-operatives, and in 1962 established an advisory unit for small industry, whose declared aim was the increase of productivity. This unit developed into the Small Industry Advisory Centre, which was officially formalised in Geneva in 1966, by an agreement between the State of Israel as represented by the Ministry of Commerce and Industry and the Ministry of Labour, and the relevant United Nations agencies. The initial duration of that agreement was for a period of four years, which has since been extended. The United Nations participated by financing equipment, sending experts and providing training courses. The Centre sponsors research relating to small businesses, organises lectures and study workshops and offers practical advice and instruction aimed at improving productivity among small business owners and managers.

A qualitative definition of small businesses has been suggested by the director of the Israeli Small Industry Advisory Centre,[10] but that definition has not been repeated or adopted by any official channel, either administrative or legal.

The Yearly Israeli Statistical Publication of 1978[11] divides the country's industrial sectors according to an ownership criterion and recognises the following four types of ownerships: Private - by the individuals; Histadrut - by the workers' union; Public - by share issuing corporations; and State - by the Government. Their actual sizes are distinguished by the number of their employees, which are grouped in a progression of five employees, from 0 up to 30. Thereafter the increases are up to 50, 100 and over 300 employees.

Though the existence of small businesses is acknowledged, their needs for preferential laws or treatment have not been admitted. This might be due to the fact that because most Israeli businesses are small not only in relative terms, but also in real ones, it is felt that any grant of privileges

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10 Ibid.

11 The Yearly Israeli Statistical Publication, 1978, No.29, The Central Office of Statistics, Jerusalem, p.437.

would not be restricted only to a small sector, but would encompass a large part of the national industry, which would inevitably dilute the effectiveness of the concessions.

Publications from and about the People's Republic of China indicate the existence of small businesses[12] which are also referred to by name.[13] Theoretically, smallness is not limited to a specific type of ownership such as private, co-operative or public (belonging to all the people), and can be used in the description of any of them, but because public ownership is large by its nature, small businesses are found only in the private and the co-operative sectors and not in the public ones. Recent changes in economic policy and rising unemployment have resulted in the actual encouragement of small businesses, in the form either of private, or of co-operative[14] ownership. But a legal definition of what constitutes a small private business or a small co-operative does not exist.

It seems that small businesses exist in the four mentioned countries, and their existence is recognised by the controlling economic organs of their respective governments. Yet none of the countries has a legal definition of a small business.

The actual lack of a definition does not eradicate the defined, or eliminate its existence. It does however prevent others from recognising and identifying it. Similarly, it might be claimed that the deficiency of a unitary definition of small businesses has not stopped their emergence or hampered their development, which proves that such a definition is not

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12 Carl Riskin, "Small Industry and the Chinese Model of Development", China Quarterly, No.46, Apr -June 1971, pp.245-273.

13 New China's First Quarter-Century, Foreign Language Press, Peking, 1975, p.24.

14 "For More Collectively Owned Enterprises", Beijing Review, No.38, Sept.21, 1979, p.8. "Expanding Rural Industrial Enterprises", Beijing Review, No.39, Sept. 28, 1979, p.4. Rong Lie,"Country Fair", China Reconstructs, Oct. 1979, p.28.

needed. But although the non-existence of such a definition cannot be correlated to the decreased fortunes of small businesses, it has hindered any concerted efforts by official bodies to offer them the assistance which they need. The Select Committee on Small Business to the United States Senate has expressed this view in its 1979 Annual Report:

> "A basic question predominates: if the SBA cannot define the primary question as to what constitutes small business, and thereby identify the sector demographically and numerically; and if it cannot break out and explain complex economic compon ents affecting independent business; how can either the SBA or the Congress, determine whether the agency's programs are effective, and responsive, or, in fact, even needed by small business."[15]

(i) Consistency of Meaning

> "And whatsoever Adam called every living creature that was the name thereof."[16]

A name is like a label stuck on an object - one name to one object. "This indissoluble link between the word and the thing"[17] is the basis of our means of communicating ideas and instructions.

A definition aims to ensure that whenever the identical name is being used, the same meaning is attributed to it by the communicating parties. A definition attempts to spread its catchment areas to all those objects which display sufficiently similar characteristics. The more complex the defined object is, the wider is the catchment area of its definition. The simpler it is, the narrower its definitional territory. When the function, composition or shape of a defined object varies beyond a periodic accepted variance level, it becomes unacceptable to the other joint name holders, and is forced to alter

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15 Twenty-ninth Annual Report of the Select Committee on Small Business, United States Senate, Report No.96-31, Mar. 7, 1979, p.17.

16 Genesis, Ch.2, v.19.

17 Zachariah Chafee Jr, "The Disorderly Conduct of Words", 41 Colum. L. Review, 1941, pp.381-384.

its classification. An example of such a simple object is a pen. Its definition will relate to its shape, composition and function, and will include all articles which display similar, if not exact, characteristics. But if any material change of any of the defined features took place, it would result in an exclusion from the definition of that non-conforming defined. A pen with a lead core instead of ink, encased in wood and not plastic, ceases to be defined as a pen and is defined as a pencil. Because of the well defined characteristics of the simple object, it does not accommodate any variations amongst its defineds.

A business, being a more complex construction than a single item like a pen, includes among the users of the same name a wide range of organisations, loosely related by the commercial or rather financial interest they share. This causes organisations with differing sizes, origins, modes of operation, targets and rates of success to be joined under the heading of one definition, namely business.

Definitions, like names, are static in nature. But the objects they define are dynamic and ever-changing. This incongruity between the dynamics of names and named is bound at some point to create a contradiction whereby objects hitherto answering to the same name have altered to such a degree that they have been transformed into totally different defineds which merit to be attached to another definition, or to be independently grouped and defined.

The fountain pen of 20 years ago has little in common with the "Pentel" of today. Yet they are still grouped together and classified as pens. This is so, because "Pentel" has not made a sufficient break with the old fountain pen. Had it not used ink, and had the casing not simulated that of a fountain pen, and had the shape been conical and not elongated, then the "Pentel" would have had to abandon the name "pen", and either attach itself to another, more related definition or start its own individual one.

By clamouring to be defined differently from the general definition of "business", small business claims that it no longer conforms to that general definition, because it has deviated from the characteristics of the definition to such an extent that it can no longer share the same name. Small businesses claim that the wider definition of business does not suit them, because it does not convey the meaning of their specific operations. The difficulty of their definition[18] is due to their diversity of economic activities,[19] legal structure[20] and size, which ranges from 1 to 1500 employees.[21] The fact that they operate within different socio-economic legal systems extends the problem, as it is difficult to envisage the common link between the Chinese rural small enterprises which Carl Riskin described,[22] and the USA small businesses which R. Wilson[23] wrote about in his outline of USA urban policy. And it is even more difficult to accept that the name "small business" denotes the same meaning in countries which are so far apart.

It is because small businesses operate in such diverse political, legal and economic climates that the search for a unitary definition has been

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18 Rein Peterson, Small Businesses, Building a Balanced Economy, Press Porcépic, Ltd., Ontario, 1977, p.58.

19 J. R. Davies and M. Kelly, Small Firms in the Manufacturing Sector, Committee of Inquiry on Small Firms, Research Report No.3, HMSO, 1972, Ch.2, p.3.

20 Ibid., Ch.3 (ii), p.4.

21 (a) 200 employees according to the Small Firms Report of the Committee of Inquiry on Small Business HMSO, 1971 p.3,
(b) 500 employees according to section (18a) of the USA Selective Service Act. Public Law 759, 80th Congress.
(c) 1500 employees according to the Small Business Administration Regulation (USA), where petrol refining industries are still considered small with 1500 employees, 13 CFR Section 121, 3-9 (1).

22 Carl Riskin, "China's Rural Industries: Self Reliant Systems or Independent Kingdoms?", China Quarterly, Mar. 1978, p.77.

23 Reese C. Wilson, Director, Centre for Urban and Regional Policy, "Public Policy approaches to Small Business Effectiveness", A Paper delivered at International Symposium of Small Businesses, Anaheim, California, Nov. 1978.

discarded[24] and has been replaced by efforts centred on improving their economic functions[25], solving their problems and forecasting their future.[26] Consistency of meaning has been confined to the definition of the small business within a specific act, or an administrative department.

(ii) The Need for a National Small Business Definition

The lack of a national uniform administrative or legal definition of small businesses has not eliminated their actual existence, neither has it discouraged new entrants from joining that sector. It has, however, prevented legislators and/or administrators from carrying out their duties in the best interests of the economy in general, and that of small businesses in particular. This has been pointed out by the Small Business Sub-Committee to the USA Congress,[27] which claimed that if what constituted a small business could not be defined, how could the legislator determine how to legislate and for whom?

The two extremes, that of the "laissez faire" policy which rejected any state intervention on the one hand, and the state controlled economies of the communist countries on the other, have been gradually narrowing the gap between them, with the former contributing towards the narrowing of the gap at a faster rate than the latter. The capitalist economy of the USA has practised state control over the economy and the ecology[28] since the **Sherman Anti-Trust Act 1890.** It did so by controlling growth

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24 H. Notenboom, European Communities, European Parliament Working Documents, 1977-78, Document 518/77, Feb. 8, 1978, p.13.

25 Text of Keynote Address of Mr Tomosaburo Salson, Director-General of the Small and Medium Enterprises Agency (MITI) of The Government of Japan at the Fifth International Symposium of Small Businesses, Anaheim, California, Nov. 1978.

26 Jonathan Boswell, The Rise and Decline of Small Firms, Allen & Unwin, 1973.

27 Supra, note 15. p.40.

28 The last 13 years have seen an upsurge in USA government intervention in controlling the affairs of the economy in relation to the consumer, the workers and the environment.

through fiscal and monetary means, and by encouraging development through direct aid in the form of financial loans[29] and indirect concessions expressed in easier taxation.[30] The last decade has seen unparalleled state intervention in the management of the economy and the environment by the "free market" economies.

Recently, the communist economy of the People's Republic of China seems to have recognised the power of economic stimuli and profit motivation and has introduced elements of free market play into its hitherto rigidly controlled industry.[31] Though the measures taken to liberate part of the economy from central planning and control are of limited scope, it is a step in the desired direction. A small business definition is imperative for the capitalist and the socialist economies, because both, each in its own way, engage in the dirigism of the economy. Without the knowledge of who is to be controlled it is impossible to exercise control.

The absence of a definition does not stem from lack of data about the small business universe, because the concept of small business is as old as

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29 Section 7(b)(5) of the Small Business Act, 15 USC, authorises the Small Business Administration (SBA) to make direct or participation loans as it determines.

"... to be necessary or appropriate to assist any small business concern in effecting additions to or alterations in its plant, facilities or methods of operation to meet requirements imposed on such concern pursuant to any Federal Law...any State law enacted in conformity therewith, or any regulation or order of a duly authorised, Federal, State, regional, or local agency issued in conformity with such Federal law, if the Administration determines that such concern is likely to suffer substantial economic injury without assistance..."

30 The removal of tax consideration in choosing a form of business organisation, was first recommended in 1927 by the then Secretary of the Treasury, Andrew Mellon. In 1953, President Eisenhower recommended such removals in his budget message of Jan. 16, 1953. In the Internal Revenue Code of 1954, the Senate introduced a proposal to allow small corporations to elect to be taxed as partnerships, (Report No.1622 83rd Congress 2nd Session, 1954, p.119). The proposal did not pass the Committee stages (HR Report No.2543 83rd Congress 2nd Sess., 1954, p.72). In 1958, the Senate offered a revised version of the proposal (Senate Report No.1983 85th Congress, 2nd Sess. 1958, p.87) which was enacted as sub-chapter "S" of the Internal Revenue Code.

31 Liu Guoguang and Zhao Renwei, "Socialist Economic Planning and the Market", Beijing Review No.31 Aug. 3, 1979, p.8.

the study of economics itself.[32] It is known that small businesses operate in diversified economic areas[33] and are an important part of the national economy.[34] Their birth and bankruptcy rates are closely monitored,[35] as are their efficiency and productivity achievements.[36] The motivation of their management has been studied at length,[37,38] and their future speculated upon.[39] Special tax concessions have been asked for them [40] and granted;[41] and, in the UK, new trading forms are being proposed for them.[42] On the whole, their existence is acknowledged, as is the fact that their problems and needs differ from those of big business, chiefly because they do not benefit from the economies of scale and the efficiency of management,[43] which characterise the large concerns.

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32 Peterson, supra, note 17. p.40.

33 Michael Chesterman, Small Business, (Modern Legal Studies), Sweet & Maxwell Ltd., London, 1977, p.1.

34 Professor C.M. Schmitthoff (ed.), Palmer's Company Law, Vol.1, Stevens & Son, 22nd edition, London, 1976.

35 Dun & Bradstreet, Report on Bankruptcy in USA, 1972.

36 Graham Bannock, The Small Business in Britain and Germany, Wilton House Publication, London, 1976, p.90.

37 J. Stanworth and J. Curran, Management Motivation in the Small Business, Gower Publication, UK, 1973.

38 C.W. Golbey and G. Johns, Attitudes and Motivations, Committee of Inquiry on Small Firms, Research Paper No.7, HMSO, 1971.

39 Norman Macrae, "The Coming Entrepreneurial Revolution", The Economist, Dec. 25, 1976.

40 Enterprise into the Eighties, Confederation of British Industry, Oct. 1977.

41 Finance Act 1978 par.17(2) reduced the rate of Corporation Tax for small companies to 42%.

42 Joe Hayton, Towards the Proprietary Company, The Conservative Party, Small Busines Bureau, Mar. 1978.

43 A report on The Impact on Small Business Concerns of Government Regulations That Force Technological Change, USA Small Business Administration, Sept. 1975, p.13.

The UK Government has established a special department and an advisory service to deal with their needs and problems.[44] The US Congress has passed a special law for them[45] which, amongst other benefits, has established the Small Business Administration (SBA),[46] as an independent Federal Agency, under the general direction of the President himself, in order to ascertain that their interests are guarded and promoted. The SBA employs some 5000 personnel, engaged in financial and management assistance to small businesses, the procurement of Government contracts, and the overall advancement of their cause.

In Israel, small businesses have been closely monitored for the past 10 years. In March 1969, in a symposium held by the Small Industry Advisory Centre,[47] the problems of finance,[48] labour[49] and Government development policies[50] regarding the small business were thoroughly discussed. In July 1973, S. Dombrovsky submitted a paper[51] expounding on the relationship

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44 The Small Firm Division of the (then) Department of Trade and Industry, now Department of Industry, and the Small Firms Advisory Bureau.

45 The Small Business Act 1953.

46 The Small Business Administration (SBA) was established by the Small Business Act on July 29, 1953.

47 The Israeli Small Industry Advisory Centre is a joint venture of the Ministries of Industry and Labour, the Federation of Small Industries, the Industrialists' Association and the General Workers' Union, the Histadrut.

48 A. Fein, "The Financial Problem and Its Implications on the Small Concern", presented at the Symposium dealing with Factors Influencing Small Industry, Tel Aviv, Israel, Mar. 12, 1969.

49 P. Horburger, "Workforce Problems", presented at the Tel-Aviv Symposium (supra, note 48).

50 G. Lahav, "Development Policy of Industry in Israel and its Implication on Small Industry", presented at the Tel-Aviv Symposium (supra, note 48).

51 S. Dombrovsky, P. Beck and L. Atinger, "The Relation between the Size of an Industrial Unit and Productivity", report submitted to the Israeli Centre for Productivity, July 1973.

between the size of an industrial unit and its productivity, to which he attached the uniqueness of the small business. In 1976, he submitted updated findings[52] and recommendations regarding the potential of small industry in Israel.

The knowledge and data accumulated about small businesses, in the countries under research, have been sufficient to offer a solid base on which to construct a uniform definition, if not to suit all of them, then at least to accommodate each one separately. But, despite this, such a definition has not materialised. In the USA, the SBA still excuses the lack of a unitary small business definition to its continuing search for more accurate data,[53] at a time when other definitions containing less information about the composition and functions of their defineds are being introduced. The lack of a definition can therefore not be blamed on the lack of data, but might be explained by a political reluctance to create a privileged group, clamouring for concessions and special treatment in an ever-changing economic climate.

The anomaly of the situation is that although it is common knowledge:

1. that there exist economic undertakings known as small businesses;
2. that these undertakings differ from big business in their size, mode of operation and resources;
3. that if they were to expand and prosper, special legislative consideration ought to be given to them;
4. that no effective legislation can be promulgated without a definition of small business;

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52. S. Dombrovsky, "The Potential of the Israeli Small Industry in a Macro-Economic Context", Report (in Hebrew) submitted to the Israeli Institute of Productivity, June 1976.
53. Anthony S. Stasio, The Study of Small Businesses, a report headed by the acting Assistant Administrator for Advocacy and Public Communications at the Small Business Administration, published by the Office of Advocacy US Small Business Administration, June 3, 1977, p.15. The report was conducted and prepared pursuant to PL 94-305.

this long overdue definition has not been forthcoming, because of the reluctance and inhibition on the part of the authorities to give a section of the economy a privileged status.

(iii) The Importance of an International Unitary Definition

While the need for a national uniform definition of small businesses is clear, the necessity for a universally uniform one is less obvious. From the legal point of view a national definition would suffice, as most legal and administrative regulations apply only within the territorial boundaries of the legislator's state. Also from an economic point of view, there is no need to strive towards a universal unitary definition, as it has been acknowledged that the activities of small businesses revolved around narrow geographical territories.[54] Only a minority of them operated at a national level and fewer still at an international one. Therefore, from the pragmatic practical approach, a national localised definition of small business is all that is needed.

The arguments against a universal unitary definition of small business rely on the quantitative variations in the meaning of "small" in the different countries, which reflect the overall size of their respective economies. This argument could have been valid, had it been established that the uniqueness of small business depends only on its quantitative size factors. But were it accepted that small business is a concept and not merely a contracted sub-group of "business", then it should be possible to develop a uniform definition for it. A concept, being a phenomenon reproduced over time and place, ought to be universally defined, especially when the task at hand is the comparison between international legal regulations. Without a uniform definition of the compared object, no such comparison can be undertaken. And desirable as it is to formulate a universal definition of small businesses

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54 Commission of the European Communities, Com.(78) 137 final, Brussels, Apr. 4, 1978, Ch.1.2(iii).

it might prove impossible if it were found that the meanings attached to the concept of small business in the four researched countries are totally different.

The up-to-date record as regards the existence of a universal uniform definition of small businesses is discouraging. A report by the Commission of European Communities, while referring to the definition of small businesses,[55] concluded that there was lack of agreement as to what constituted a small business and that a legal, economic or statistical definition did not exist. A study by UNICE[56] (Union des Industries de la Communautée Européenne) resulted in similar conclusions, namely that no official definitions of small and medium-sized enterprises, or of the artisanat existed.

The variances in the definitions proffered for small business, and the hitherto negative results in reaching a uniform definition, have prompted the writer to compare the definitions used in countries having extremely different economic systems, rather than similar ones. Although the comparison of similarities might seem to be a more practical pursuit,[57] it essentially amounts to the transportation of ideas and practices from one part of the globe to another. Not that this is not a valuable process. But such a comparison can prove fruitful only where and when the ideas or, as in the present case, the definitions, have already been agreed upon and formulated by the relevant countries. Yet if, as is the situation with the small business definition, no country has adopted a uniform definition, then

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55 Definitions of Small and Medium Sized Enterprises and the Artisanat, 413/III/76-E. Orig.I. Commission of the European Communities. Directorate General for Industrial and Technological Affairs; Small and Medium Sized Enterprises; Artisanat Division, Apr. 1976, p.1.

56 J. Turner, Small & Medium Sized Enterprises, a report; conclusion and recommendation in respect of their financing. Compiled by the working group on financing of the UNICE committee for the Study of the Problems of Small and Medium Sized Industrial Enterprises. Jan. 1978.

57 L.C.B. Gower, "Some Contrasts Between British and American Corporation Law", 69, Harvard Law Review, 1955-56, p.1370.

it is believed that by confronting and comparing the meanings attributed to it by the extremes of the economic systems, the deadlock might be resolved and an appropriate definition will emerge.

Conclusion

Though the existence of phenomena does not depend on the existence of their definition, its absence prevents others from recognising and identifying it, and consequently also from communicating clearly about it.

An agreed national definition of small business is essential if legislations were to treat it in a consistent manner, so as to enable a business to realise its status, irrespective of the contextual meaning of each individual legislation. An agreed international definition of small business is desirable for the promotion of economic co-operation and communication, that without such an agreed definition is unattainable, and if attempted is inconsequential.

CHAPTER THREE

DEFINITION CLASSIFICATION

Introduction

A definition is originated in order to classify objects, phenomena or concepts in an orderly manner, and assemble all the similar ones into their appropriate familial groupings. An incorrect definition is one which does not correspond to the reality of the defined. A wrongly classified item does not only disrupt the harmony of the order, causing inconvenience to others, but causes most harm to itself. An incorrect classification might encumber the item with extra duties wrongly imposed on it, or additional rights it was not equipped to enjoy. The thing most affected by a definition is therefore the defined. It is therefore in its interest (in the context of the present thesis the defined is the small business) to be aware of the identity of its definers, the criteria they used in the definition, as well as their consequent power over its implementation.

A definition is not just an isolated sporadic statement of facts or impressions, expressed by anyone and affecting no one. It is a statement regarding a pre-defined sphere, by a pre-determined definer, who uses pre-established criteria, which impose a set of relationships between all the active and/or passive parties, who are involved directly or indirectly either in its formulation or in its implementation.

Definitions can be divided into four categories in accordance with the inter-relation of their parties and the type of criteria used in their formulation. The four categories of definitions are: scientific, juristic, legal and administrative.

(i) Scientific Definition

The scientific definition concerns two parties, the definer and the defined. The definer is the originator and promulgator of the definition and the defined is the person, object, phenomenon or concept that the definer has defined.

The role of the definer can be undertaken by any person, as long as he intends to describe the defined in the most accurate and truthful manner. The criteria he uses for the definition can belong either to the quantitative or the qualitative categories. The definer is the most active party of the definition, as it is he who originated its existence. But his interest in it, and in the defined, ceases with the formulation of the definition. The defined, being the passive party, is usually not consulted for its views about itself, as it is only the definer's opinion that counts. A scientific definition concerns only a limited sector of the population, which is restricted to the definer and his circle of followers and colleagues.

(ii) Juristic Definition

A juristic definition is promulgated through a legislative process by a specific legal rule or regulation, especially designed for the interpretation of that specific rule or regulation, and not for the entire legal code or the totality of the same defineds. As a result, a juristic definition does not affect all the identical defineds, but only those which come under its jurisdiction.

Although a juristic definition does not include the entirety of the same defineds, it affects a wider section of the population than the scientific definition. And because it implicates not only the definer and his inner circle of followers, a juristic definition does not confine itself to a mere accurate duplication of the defined, as is done by the scientific

definition, but considers also the context of the defined's environment and the ultimate consequences the definition might bear upon it. By including in its definition factors other than those intended merely to describe and identify the defined, the juristic definition concedes to, and enables the existence of several differing definitions of the same defined. The juristic definition does not have any claims to exclusivity; it does however attempt to formulate a compromise between the different prevailing definitions of the same defined, as well as between the interests of the defined and those of its environment.

A further differentiation between the juristic definition and the scientific one lies in their methods of formulation and scope of application. The former is a composite compromise of prevailing opinions and definitions whose enforceable quality guarantees it a wide territorial application; while the latter is the result of one person's opinion and belief with a limited application, which is unenforceable if disagreed with.

The weakness of a juristic definition is in its concession to compromise, rather than unwavering accuracy. Yet, this same weakness accounts also for its superiority over the scientific definition. Along the route towards compromise, it perceives the defined from all possible angles and dimensions, and relates it not only to its present context, but to its past and future ones as well.

(a) The Parties to the Juristic Definition

A juristic definition concerns four parties: the definer, the defined, the applicator, and the applicant.

(a.1) The definer

The definer's role can be undertaken by either the legislator or the administrative regulator. The difference between their resultant definitions is that the legislator is empowered to use either qualitative or quantitative criteria, whereas the administrative regulator can rely only on quantitative

criteria. The type of criteria used is of relevance when the definition is referred to its applicators, as not all the applicators are empowered to apply all the definitions. Between them, the two juristic definers have the power to apply the definition to a wide section of the population, and to impose it on the applicators and the applicants alike.

Like the scientific definer, the juristic one sets out to find a common denominator to the defineds, which can consist of a set of horizontally or vertically recurring phenomena. His aim is to establish criteria by which future similar phenomena will be recognised. He initiates his own task, and as such is the foremost active party in the definition. His role in the definition, and his interest in the defined, terminate with the formulation of the definition.

(a.2) The defined

The defineds are usually a series of vertically or horizontally recurring phenomena. In the context of small businesses, they are the type of commercial enterprises claimed to differ from large businesses. The defined is the passive party of the definition, and his assessment of himself is of minor value to the definer, who considers many different assessments prior to his formulation of the definition. The defined's involvement in the definition, like that of the definer, ceases with its emergence.

The defined is to the definer what the model is to the painter, a necessary participant in his creation, but a passive one. The defined needs and depends on the definer and not on the definition, to the same extent that the model relies on the painter, and not on the painting.

There are, however, situations when the defined joins forces with several other similar defineds, in an attempt to persuade the definer of the incorrectness of the definition, with the aim of causing him to alter it, in order to suit their interests. These are the sectoral pressure groups that lobby the definer, usually prior to, but sometimes also after, the

promulgation of the definition. This practice prevails particularly in the USA,[1] where small businesses (and other sectors) are organised into very vociferous trade associations. Even in the People's Republic of China,[2] there are occasions when defineds attempt to persuade the definers to alter their definition. Such occurrences, when the defined attempts to influence the definer, are an exception to the former's traditionally passive role in the definition.

(a.3) The applicator

The applicators are appointed either from the judiciary or from the administration. Their task is to ascertain the accurate implementation of the definition by examining the applicant's eligibility to be included in or excluded from it. They are continuously involved with the definition, and the duration of their role is indefinite.

For them the definition acts as a measuring tool with which to verify the claims of scores of applicants, regarding their closeness to, or

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1 (a) William M. Diamond, The Differential Impact of Government Regulations on Small vs Large Business. A research report prepared for the US Congress Joint Economic Committee. Authorised as a Special Study on economic changes, Apr. 1, 1979, p. ii.

(b) "How Congress voted on Mandate issues", 95th Congress first session. Published January 1977 by the National Federation of Independent Businesses.

The small business trade associations inform the Congress, the House of Representatives and any specific committee which deals with issues relevant to small businesses of their members' opinions, wishes and needs.

The National Federation of Independent Businesses, NFIB, with some 500,000 members, follows each Congressman's voting record re issues closely or remotely related to small businesses. The NFIB then publishes such records, and circularises them among their half a million member firms, which cover at least some 3 million votes. The aim of such publications is to gather support and influence for small business issues.

2 "Petitioners' Problems must be solved," says People's Daily, news item No. 091704, Xinhua News Agency Sept. 17, 1979., p.11.
The news item deals with a pilgrimage of thousands of wrongly "defined" citizens who rallied to Beijing in an attempt to persuade the definers, the Party Central Committee, to alter their definition of the defined from "counter-revolutionaries" to law-abiding citizens.

remoteness from, the boundaries of the definition. Of the four parties to the definition, the applicators have the most continuous need of and dependency upon it, as they are the only ones who need to utilise the actual promulgated definition in their allocated roles. And while the defined can function without a definition, and the definer's need for it lasts only until its formulation, the applicator's role is non-existent without it, and his need for it is continuous, as it is repeatedly used for the execution of his functions.

The judicial applicator is entrusted with the application of both types of definitions, the ones created by the legislator using quantitative and qualitative criteria, and those introduced by the administrative regulator, relying solely on quantitative criteria.

The administrative applicator is empowered to deal only with the definitions which are originated by the administrative regulator.

(a.4) The applicant

The applicant is a potential defined who is not certain as to his inclusion in or exclusion from the definition. He aims to be either excluded from it, or included in it, depending on the ensuing consequences of the definition. His petitions to the applicator are based on his own perception of his similarity or dissimilarity to the defined. In contrast to the defined, the applicant participates actively in the definition, as his inclusion in it, or exclusion from it, can mean a difference between success or failure to him. Where a small business is concerned, it can amount to financial remunerations or losses. And as it is the applicator's task to verify the fit between the definition and the applicant, it is not difficult to envisage the inevitable conflicting interests which might develop between them. The applicant appeals to whoever has authority to deal with his application, either the judicial applicator or the administrative one.

Usually the applicant is a single specific phenomenon, but sometimes a number of applicants of similar size from the same locality or industry

apply collectively to the applicator. Such joint applications are undertaken in order to compel the applicator to establish a fit not merely between the definition and one particular applicant, but between the definition and each of the joint applicants, which means an initial fit among the applicants themselves, in addition to the fit between each one of them and the definition. The applicants reason that by exposing the applicator to the pitfalls surrounding such an elaborate process of comparisons, they stand a better chance of achieving their aim of inclusion in, or exclusion from, the definition, than if they had applied separately. Such joint applications are usually undertaken by trade associations submitting petitions on behalf of their members.

The normative behaviour of the applicant is such that, unless the definition is being specified as a pre-condition for remuneration or losses, he does not take an active part in it, as he is being activated by the direct bearing of the definition on his personal welfare.

(b) The Phases of a Juristic Definition

Three distinct phases can be observed in the duration of a juristic definition: the pre-definition, the intermediate, and the post-definition phases.

The pre-definition phase involves only its two originating participants, namely the definer and the defined. And although the formulation process in the pre-definition phase of the definition can be a lengthy one, it is relatively short in comparison with the post-definition phase. The apex and simultaneous cessation of this phase occur with the formation of the definition, when the originating parties lose their interest in it, and relinquish their roles without handing them over, or establishing the identity of their successors.

The intermediate phase takes over from the pre-definition phase, and lasts until the post-definition phase. Throughout it, the definition exists in

a quasi-dormant state, without attracting any interested parties. This state of affairs continues until the definition is selected as a condition for the grant of extra privileges or the imposition of duties. The incorporation of the definition into a law or regulation signifies the end of the intermediate phase.

The post-definition phase starts with the inclusion of the definition into a privilege-granting or duty-imposing law. This activates hitherto passive applicants, who appeal to the applicator to be identified with or differentiated from the definition. Their activity stops only when the definition ceases to act as a pre-requisite for the grant of benefits, or the imposition of duties. At that point, the definition reverts to its quasi-dormant, intermediate phase.

Of the two parties which are active in the post-definition phase, the applicator is the one who utilises the definition continuously, while the applicant's need for it ceases once his status has been determined.

(iii) Legal Definition

A legal definition is one which is formulated by a legislative process, and is empowered to denote the same meaning to all identical defineds in any legislation in which they are referred to, in a direct or indirect manner. A legal definition supersedes any differing juristic definition. The relationship between a legal and a juristic definition can be compared to that of a written constitution and its subordinate legislation. For a definition to merit the status of a legal definition, it has to be accepted as the exclusive juristic definition of a given defined, in a sovereign state, at a certain point in time.

In legal systems which subscribe to a written constitution, any definition which forms part of such a constitution becomes automatically a legal definition. But when a definition is not part of such a constitution, or in legal systems which do not have a written constitution, the

verification of the existence of a legal definition of a given defined is a lengthy and complicated process, because all the potential legal definitions originate as juristic ones, structured for specific legislation. Yet not all juristic definitions develop into legal ones; only in certain situations is a juristic definition elevated to the ranks of a legal definition. The point of time at which and when a juristic definition transforms itself into a legal one is elusive. To prove the exclusive existence of a legal definition is to capture a fleeting moment, because today's exclusive legal definition might cease to exist altogether tomorrow, with the introduction of a new and different juristic definition, claiming its right as: lex posterior derogat priori. Alternatively, if not significantly different from the new juristic definition, it regresses to its previously held title of a juristic definition, and reverts to the position of becoming one amongst equals. As a rule, a defined can attract only one legal definition at any given time, but several juristic definitions.

The ephemerality of the legal definition is responsible for the difficulty of ensuring its existence, or the exact time of its commencement or termination. A legal definition is found to exist in the following situations:

1. when it is the only juristic definition of a defined;
2. when it repeals all previous legal and/or juristic definitions of the defined;
3. when it is common knowledge that only one definition exists.

Knowing when and where a legal definition exists does not in itself prove that it actually does. In order to prove that a definition is actually a legal one, and not merely juristic, it is necessary to substantiate each situation.

Situation No. 1 - Although in principle it is possible to prove that a certain definition is the only existing one, hypothetical problems of interpretation could be encountered. An example in point would be a positive definition of a small business, which had not previously been included in any legal or juristic definition. Had the concept of "business" been defined, it could be claimed that it is inclusive of "small business", which is a mere quantifier of the overall concept of "business". Were such an argument to be accepted, it would mean that a "small business" definition had already existed within the definition of "business"; but were the argument rejected, it would mean that such a definition had not existed.

Another hypothetical situation could be the existence of a definition defining a related defined, such as a "small company". If such a definition existed, it could be claimed that a "small business" is similar to a "small company", and is therefore likewise defined. On the other hand, such a claim could be rejected on the grounds that a "company" is not synonymous with a "business".

Although these might seem to be only technical problems, the inability to solve them satisfactorily precludes the assurance that the defined had not been previously defined. Consequently, the definition could not be considered with certainty to be the only existing definition of the defined, and therefore to be a legal definition.

Situation No. 2 - requires the ascertainment that all the previous definitions have been nullified. Compliance with the present situation raises even more complex issues than those already encountered, as most laws do not insist on an outright abolition of former legislation, for fear of creating a legal vacuum. They prefer, instead, to repeal only contradicting legislation. The ensuing ambiguity stems from the fact that the meaning of contradiction depends on interpretations, which are subjective in their nature.

An example in point is the US definition of small business, as found

in the **Selective Service Act 1948**,[3] which has not been repealed by the **Small Business Act 1953**,[4] because prima facie it is not a contradicting definition. This view is not unanimously supported. According to some opinions, the former definition contradicts that of the **Small Business Act**, and ought to be abolished.[5]

Had a definition been empowered to cancel all the former ones of the same defined, and not just contradicting ones, it would have been possible to establish that definition as the exclusive legal definition of the given defined. But such definitions, with sweeping cancellation powers over previous definitions, are rarely encountered in connection with common defineds. Consequently, even those definitions which have implicitly cancelled previous contradicting definitions cannot be trusted to have actually achieved that goal, as the meaning of "contradicting" rests with its interpretation.

Situation No. 3 - deals with those definitions whose exclusivity is a "common knowledge". The "common knowledge" label can be attached only to major definitions, defining the fundamental conduct and structure of society. The major definitions constitute the felonies of the criminal codes, and the basic concepts of the civil and commercial codes which, if attached to more than one definition, would create uncertainty, likely to result in social disorder. It is "common knowledge" that there exists only one definition of murder per sovereign state, or of theft or of treason. Had this not been so, it would have shaken the foundations of any legal system. The same

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3 The Selective Service Act 1948, Public Law 759, Sec 18(a).

4 The Small Business Act 1953, 15, USC 650.

5 Preliminary Report of the Sub-Committee on Government Procurement, Disposal and Loan Activities to the Select Committee on Small Business, House of Representatives, Report No. 1045, The Small Business Administration and Related Activities, July 1, 1955, pp.7-9.

exclusiveness applies to the major civil institutions, such as marriage, divorce and inheritance. In commercial law, it would be "common knowledge" that only one definition of a limited company, bankruptcy or a debtor existed. As regards the minor definitions, like that of "small business", the "common knowledge" assumption cannot be claimed.

Theoretically, a legal definition could exist in each of the three mentioned situations. But, as shown, it is extremely difficult to prove the existence of the first two situations, while the third is limited only to the major definitions. It can be surmised that the existence of legal definitions is the exception rather than the rule. The non-existence of a legal definition[6] of small business should therefore not be viewed as an anomaly because, as demonstrated, only a few legal definitions exist.

(iv) Administrative Definition

The administrative definition, like the scientific one, has only two participants, the definer and the defined. But whereas the definer and the defined of the scientific definition can be anyone and anything, those of the administrative definition are restricted, in that the definer can only be an authorised member of the administration, while the defined can only be one which either the legislator or the administrative regulator has authorised as a subject for definition. The criterion used by such a definition is restricted to the quantitative type.

The absence of an applicator and an applicant prevents any recourse from the defined against the definer. And therefore in countries which adhere to the "rule of law" system, the administrative definition is used

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6 Definitions of Small and Medium Sized Enterprises and the Artisanat, 413/III 76-E. Orig. 1. Commission of the European Communities. Directorate General for Industrial and Technological Affairs. Small and Medium Sized Enterprises, Artisanat Division, Apr. 1976, p.1.

only for administrative purposes, such as for statistics, or inter-departmental work distribution. In less democratic regimes, where the defineds' lack of recourse is of secondary importance, the administrative definition enjoys a wider use.

Conclusion

The four types of definitions, scientific, juristic, legal, and administrative, are not of equal standing. The relative prominence of each can be evaluated according to its territorial influence; the smaller, the less important it is; the larger, the more consequential.

At the bottom of the scale is the scientific definition which affects the smallest number of persons or items. Its territorial influence is limited to scientists and/or academics who are concerned with the limited area to which the defined phenomenon belongs.

The correct positioning of the administrative definition is not as clear as that of the scientific one. In favour of allotting it the second position in the scale, just above the scientific definition and beneath the juristic one, are the facts that, like the scientific definition, it has only two participants, a defined and a definer, which limits it to a level of an internal encounter between the two, without involving the wider public. Yet the fact that the administrative definition results mostly in statistical data cannot be ignored or dismissed as irrelevant, because though statistical findings cannot be challenged directly by an applicant, their indirect influence on the status of the defined has long-term effects, as they assist in shaping the administration's future policies with regard to him.

In non-democratic regimes, where the "rule of law" is not strictly observed, the administrative definition can find itself at the top position of the scale of prominence, even above the legal definition, because it becomes

a tool in the hands of the administrators who are undisturbed by its absence of applicator and applicant, and by its unsuitability for a wide use, and employ it for the purpose of policy implementation, against which there is no possibility of appeal.

The juristic definition is of less prominence than the legal definition, although both have four participants, the definer, the defined, the applicator and the applicant, because the juristic definition defines the defined only for the purpose of one specific legislative act, beyond which it is ineffective. The aim of a legal definition is to attach itself to the defined in all his relations and encounters with the law, as well as impose its definition of him on all the other legislative acts. Therefore its territory of influence is the widest, hence its prominence over all the other types of definition.

CHAPTER FOUR

DEFINITION METHODS, CRITERIA AND TECHNIQUES

Introduction

A definition can be formulated by using different methods and techniques, which might bear on the actual contents of the emerging definition, and thus can become indirectly an integral part of it. For instance, the use of the negative definition technique might invoke criticism on the basis that what is not there, cannot be defined.[1] Whereas the use of a Zen Buddhist methodology would result in a non-definition, on the grounds that what exists is defined by its mere existence, and that a worded definition could never replace the actual existence of a phenomenon.

Such a technique would definitely be rejected as unscientific by those concerned with the sciences. The same would apply to the "ideological" methods of definition, such as those practised by some communist countries, in which the "should be" takes over from the "is", and which would likewise be rejected by the same quarters and for the same reasons.

It is certain that many different definition methods and techniques exist, as the numerous definers must have developed or adopted their individual ones. The definitions referred to at present are the most commonly used by the scientific, the juristic, the legal and the administrative definers.

(i) Methods

There are three basic methods by which definitions are formulated: the positive, the negative, and the exclusive methods. Any of these methods can be used by each of the four types of definition: the scientific, the juristic, the legal and the administrative.

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1 The no-right concept of Professor N. Hohefeld as expressed in his article, "Some Fundamental Legal Conceptions as applied to Judicial Reasoning", 23 Yale LJ 16 (1913) and 26 id. 710 (1917).

(a) Positive

The positive definition method takes place when the defined is defined in a direct manner aimed at accounting for its singular characteristics, irrespective of its relation to other defineds or their definitions. In a juristic or a legal definition, this method is used for the definition of the principal defined in legislation, especially when the legislator is intent on preventing ambiguity. The small business definition of the USA **Small Business Act 1953** is an example of such a positive definition. The small business, being the principal subject of that legislation, has been defined in a direct and positive manner.

Ideally, all definitions should use the positive method, as it is the clearest of the three. But because of political and technical reasons, the reality does not adhere to the ideal. The legislator has to take into account political and social considerations, which sometimes might be better served by the use of the less definite exclusive method, despite the fact that the resulting definitions might be more complicated and ambiguous.

Other situations where the use of the positive definition method is neglected are those in which the defineds are incidental to the main theme of a legislation, and have therefore not been considered important enough to merit an individual positive definition.

(b) Negative

The negative definition does not define a defined according to what it is, but according to what it is not. This method is used when it is aimed at incorporating into a definition several defineds, which are not identical, but display certain common denominators.

The positive or exclusive definition methods are reserved for identical defineds, whose common denominator is the identity of their characteristics. But as this cannot be achieved in the case of defineds which are only

similar, and not identical, a different common denominator has to be sought. It cannot be one which describes what they possess in common, but rather one which enumerates what they lack in common.

(c) Exclusive

The exclusive method of definition is used by the legislator to define defineds whose quantitative norms of identical qualitative characteristics do not conform to those of the majority. This quantitative variance is the determinant used for their exemption from duties, and exclusion from benefits. It is also used for the allocation of special requirements to them. The latter is done by the method of "tiering".

The exclusive method of definition can be carried out in three ways: by exemption, by exclusion, and by tiering.

(c.1) By exemption

Definition by exemption occurs when, because of a quantitative variance in an otherwise identical characteristic of a defined, the legislator exempts the latter from all, or part, of the duties imposed on its co-defineds. Such an exemption isolates the exempted from its co-defineds and establishes it in a separate category.

When, through such an exemption, the exempted loses most of its identity with his former co-defineds, it can be said that it was re-defined by the exemption, despite the fact that its definition was an indirect one.

(c.2) By exclusion

Definition by exclusion takes place in identical circumstances to those which prompt the definition by exemption. The difference is in their aims; the one exempts from duties and the other excludes from benefits. The definition by exemption is the one most commonly used, as the majority of the legislation is of the duty-imposing type.

(c.3) By tiering

Definition by tiering, like those by exemption and exclusion, defines

defineds with identical qualitative characteristics, but with different quantitative norms. Its uniqueness is that from the onset it intends to define more than one defined, and therefore allocates each an independent set of duties and/or privileges. In this it differs from the aforementioned definitions, where the defined was being re-defined as a result of the exemption, and not exempted because of the definition. This involves a major difference, because an exemption which is a result of a definition indicates the defineds's prior awareness of its duties and/or privileges. But in the reversed order of events, when the exemption precedes the definition, the defined is left in limbo, without prior knowledge of either its duties or its rights.

Any set of circumstances which withholds from the defined prior knowledge of his duties or rights contradicts the principle of the "rule of law".

(ii) Criteria

A criterion is the tool used by the definer to define a defined. It can be any characteristic, function or attribute of the defined, either positive or negative, which is significant enough to differentiate it from dissimilar defineds and identify it with equivalent ones.

Criteria are divided into two types: qualitative and quantitative.

(a) Qualitative

Qualitative criteria are those which describe the characteristics, the functions, and/or the attributes which the defined possesses or lacks, regardless of its quantitative determinants. All the criteria originate as qualitative ones, and in principle, given the right tools, could be quantified. Those which it is possible to quantify in a simple and practical manner are referred to as quantitative criteria.

An example of a criterion which can serve in a qualitative as well as a quantitative capacity, but is fundamentally known as a quantitative

criterion, is that of "employment". This criterion could describe a function of a defined, as in the case of the following definition:

A "job centre" is an institution which provides employment to those who seek it.

But it can also be used as a numerical definer, as in the next definition:

A small business is one which employs 50 persons.

Criteria such as "personalised" or "advanced" management which in theory could be quantified, are found to be impractical for such quantification in reality, and are therefore limited to function only as qualitative criteria.

Qualitative criteria are considered more profound, because of the notion that the inability to quantify them indicates more intrinsic and wholesome characteristics. This belief contributes to the stability of the qualitative criteria, which tend to stay with the defined for longer periods of time than the quantitative criteria. As a result, they are also considered more reliable and more accurate in their description of the defined. Their detriment lies in the difficulty of their verification, which relies on the accumulation of data, research and a thorough understanding of the essential components of the defined. Their final evaluation rests with the opinions of the definer and the applicator.

Because of these difficulties, the qualitative criteria have been rarely used in the definition of small businesses. Out of 75 countries researched as to their definition of the small business, only five used a qualitative criterion.[2]

(b) Quantitative

Quantitative criteria are qualitative criteria which can be numerically

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2 K.A. Aucillo, R. Johnson and L.M. Wagenveld, An International Compilation of Small Scale Industry Definition, Georgia Institute of Technology, Atlanta, Georgia, Project B-414, 1975.

quantified in a practical manner. They are considered inferior to qualitative criteria because, on account of their ease of application, requiring no specialised skill, they are in abundant use and this, together with the stigma of "arbitrariness" attributed to them, renders them inexclusive. This has helped to promote the idea that quantitative criteria are used where suitable qualitative ones do not exist, or when the legislator had ulterior motives for doing so.

(c) Criteria, and Their Relation to the Parties to The Definition

The type of criteria used by a definition affects its parties in different ways as follows:

The definer is concerned with the type of criteria used, as not all definers can use both types of criteria. The administrative regulator, who is one of the two definers of the juristic definition, and the administrator, who is responsible for the administrative definition, are entrusted only with quantitative criteria.

The defined is usually impartial to the type of criteria used, as his opinion does not count except when he attempts to refute the definition. Then he finds that it is easier to challenge quantitative criteria, because they can be substantiated with facts and figures, while an objection to qualitative criteria is doomed to failure, because they belong to the realm of opinions which are difficult to disprove, as they are subjective in nature.

The applicator is concerned with the choice of criteria, as it indicates the division of jurisdiction between the judicial applicator and the administrative one. The judicial applicator is authorised to act on the qualitative and the quantitative criteria, but the administrative applicator is allowed to function only where quantitative criteria are used. Yet even the judicial applicator prefers to deal with quantitative criteria, because of the ease with which the applicant's inclusion in, or exclusion from, a definition can be ascertained.

The applicant is disposed towards quantitative criteria, because they provide him with the means of assessing himself and other similar applicants. When he applies to be included in or excluded from a definition, he finds quantitative criteria more satisfactory, as they enable him to plead his case with greater conviction.

That all the three representatives of the executive authority, the administrative regulator, the administrative applicator and the administrator, are not entrusted to deal with the qualitative criteria, reaffirms that qualitative criteria deal with the essence of a phenomenon, whereas quantitative criteria deal merely with its degrees. Dealing with the essence requires not only a higher moral and educational level than dealing with degrees, but also a specific skill. Incorrect handling of the essence can result in greater injustices than incorrect handling of degrees. Therefore, where qualitative criteria are concerned, a clear separation of authorities exists. The definer is represented solely by the legislator, and the applicator by the judiciary.

Quantitative criteria dispense with the separation of authorities between the rule maker (the administrative regulator) and the rule applicator (the administrator), and accept the fact that both belong to the executive authority. That such concentration of power might be efficient and practical is undoubted; that it might also be dangerous is not ignored.

(iii) Techniques

Definition techniques are the ways and means of establishing the existence, or non-existence, of a consistency of meaning between what was meant by whom, what was said by whom, and what was understood by whom. They are used in the following situations and purposes:

1 between the defined and its definitions and vice versa, for the sake of establishing that the "name" is the correct one for a given item, phenomenon or concept;

2 between the definition and the meaning it denotes to its participant parties (the definer, defined, applicator and applicant), in order to ascertain that all the users of the "name" mean the same item, phenomenon or concept, when they use it;

3 between different definitions which intended to define an identical defined, so that it could be proven that the different "names" have actually meant the same item, phenomenon or concept although they named it differently;

4 between identical definitions which have actually defined different defineds, so that it could be established that sameness of "names" did not mean sameness of item, phenomenon or concept.

Definition techniques are of two kinds, subjective and objective, each of which is effective in different situations, and each of which utilises the "principal" and the "sub-definition" procedures. The former defines the name itself, and the latter defines the elements which constitute the same.

(a) Subjective

The subjective technique deals with the essential characteristics of the "name" itself, while the objective technique deals with the essential characteristics of the relationship between the "name" and an external constant factor. The subjective technique, being the simpler to operate, is therefore the more popular. When the elements which constitute the "name" have been identified, and their meaning agreed upon, a perfect fit of name to meaning has been achieved, and there is no need to use any other techniques. If, however, none or only some of the elements of the "name" have been identified and agreed upon, then the "sub-definition" procedure is required. The sub-definition is carried out within the context of the subjective technique.

Whereas the "principal" definition procedure defines the "name", the "sub-definition" procedure defines the elements of the "name", a process

which can lead to greater clarity as to the meaning of the "name" itself. Thus, by defining not merely the "name" itself, but also its composing elements, consistency of meaning can be attained. Failing this, the objective technique has to be used.

(b) Objective

The objective technique is used in the same manner as the subjective one. The only difference is that instead of defining the "name" itself, it defines the relationship between the "name" and an external factor or factors. The "sub-definition" procedure is applied to the objective technique in the same circumstances and manner as it is to the subjective technique.

The objective technique is used where no uniform definition and/or meaning of the same defined exists, and it is desired to formulate one. The non-existence of a uniform definition could be due to the inability to ascertain the common denominators of the defineds, by the use of the subjective technique; or because of the prior existence of contradictory definitions of the same defined. Under such circumstances the augmentation of another definition, based on the same subjective technique, is unlikely to resolve the deadlock. But the objective technique, by relating the name to an external factor, is able to discover new dimensions and a common denominator hitherto unobserved. This might result in a uniform definition of a "name" previously dismissed as undefinable.

The subjective and objective definition can be used in conjunction with qualitative and quantitative criteria alike.

(iv) The Equilibristic Decision-Making System (EDMS)

ADVOCATES: The Equilibristic Decision-Making System (EDMS) advocates the use of quantitative criteria in the

definition of most defineds.

OFFERS: The Equilibristic Decision Making System (EDMS) offers to demonstrate that the use of quantitative criteria is not arbitrary, nor is it complicated or inaccurate. The system is based on the ranking of all defineds, according to quantitative scales and the matching of those of equal ranks.

CLAIMS: The Equilibristic Decision-Making System (EDMS) claims that:

1. Quantitative criteria are not arbitrary, if used according to EDMS, because these are the natural criteria used in the continuous grading of all phenomena by society's norms of values.
2. Qualitative criteria should be used for the definition of major phenomena, and quantitative criteria for the definition of secondary phenomena.

   To the same extent that it is accepted that criteria are classified into higher and lower orders (qualitative and quantitative), and their applicators to "more" or "less" skilled (the judiciary and the administration), it is also recognised that phenomena are of major or secondary categories. Major phenomena are those which can be practically defined only by using qualitative criteria. Examples of major phenomena within the context of the commercial world, include: business, employer, and production. Secondary phenomena are those which can be defined by using quantitative criteria. Examples of such phenomena are: small-business, big-employer or

average-production. The Equilibristic Decision-Making System (EDMS) considers quantitative criteria to be a more refined classification method than qualitative criteria, which divide the defineds only into general categories and not into specific ones.

3. Most phenomena are of a secondary standing and should be defined by quantitative criteria. This is so, because each single major phenomenon like "business" breeds many secondary phenomena, such as: big-business, small-business, good-business, bad-business, expanding-business or contracting-business. And while the major phenomena can be adequately defined by the more general and less definite qualitative criteria, the secondary ones need the precision of the quantitative criteria, as otherwise the boundaries between them and related defineds would not be clearly marked. The definitions of a small business and a medium business have to rely on exact quantitative criteria, as otherwise no differentiation between them will be possible.

BELIEVES: The Equilibristic Decision-Making System (EDMS) believes that: all decision making involves users seeking the best uses from other users, or vice versa; and that the most satisfactory, acceptable, uncontroversial and therefore correct and inevitably harmonious decisions were those that matched equal ranking users to uses.

An example of a correct match is the matching of a user such as "big-business" to the uses of "big-turnover" and "high-profits". An example of an incorrect match, would be the matching of a user such as "big-business", to the uses of "low-turnover" and "low-profits".

RECOGNISES: The Equilibristic Decision-Making System (EDMS) recognises that:

1. each defined functions as a "user" and/or a "use" according to his/its role within a specific set of relationships between him/it and other defineds;
2. as a rule, a defined is a "user" when he/it seeks to be defined, and a "use" when he/it defines others.

An example of how defineds function both as "users" and as "uses", is forwarded in the following three sets of relationships between three defineds, namely: big-business", "big-turnover" and "big-profits".

In the first set of relationships:

"big-business" seeks to be defined by its characteristic of "big-turnover". In the present situation "big-business" is the "user" because it seeks a definition, and "big-turnover" functions as a "use" because it is used for the definition of "big-business".

"big-business" = the "user"

"big-turnover" = the "use"

In the second set of relationships:

"big-turnover" seeks to be defined by its feature of "big-profits". "Big-turnover", which in the first set of relationships was the "use", now fulfils the role of a

"user", because it seeks to be defined, and "big-profits" is its defining criterion - the "use".

"big-turnover" = the "user"

"big-profits" = the "use"

In the third set of relationships:

"big-profits" seeks to be defined by its affinity with "big-business". Consequently "big-profits", which in the second set of relationships functioned as a "use", is now functioning as a "user" because it seeks to be defined.

"big-profits" = the "user"

"big-business" = the "use"

These three sets of relationships show how each defined acts both as a "user" or as a "use", depending on whether he/it seeks to be defined, or acts as the defining criterion of another defined.

FUNCTIONS: The Equilibristic Decision Making System (EDMS) functions in the following order and manner:

1. It ranks all "uses" and "users" according to quantitative grades of big, medium and small. Each grade has its upper and lower thresholds.
2. It pairs the even-ranking "users" and "uses" in the following manner: a big "user" is matched with a large "use"; the best "user" with the best "use"; and the minor "user" with the minor "use". This matching of even ranked "users" to "uses" is efficient, because it conserves the resources otherwise needed to adjust a lower-ranked "user" to a higher-ranked "use", or vice versa. It is also effective because it eliminates

the futility and confusion created by the mis-matching of "users" and "uses".

USAGE: The Equilibristic Decision Making System (EDMS) is used in the following manner and order, as illustrated by the example of the small business that seeks to be defined.

1. The small business checks its ranking to verify whether it is classified as a major or a secondary phenomenon.
2. On finding that it is a secondary phenomenon, it searches for the quantitative criteria, as secondary phenomena can be defined only by those.
3. The defined establishes its identity as a "user" or a "use". Being the one in search of a definition, it is the "user".
4. It looks for suitable "uses" with which to be defined. Suitable "uses" are those related to the "user". In the case of a small business, "uses" such as employees, turnover, taxation, and the like would be considered suitable, whereas "crime-rate" will not be appropriate.
5. The defined adjusts the rank of the "uses" to his own rank as a "user", which results in a definition.

EXEMPTIONS (examples):

1. A big business with a big turnover and low profits is an example of an exemption to EDMS, of matching equal ranking "users" with equal ranking "uses", because this is an incorrect matching of a "user" from a higher rank,

to a "use" of a lower one, and such a situation should not be allowed to continue. In reality, the profit "use" has to be urged to improve its performance and to equalise itself to the level of a big business with a big turnover.

2. A small business which asks to be defined by a qualitative criterion is an example of an exemption from the ruling of EDMS that small business is a secondary phenomenon. The small business, wishing to be defined with other criteria than those recommended by EDMS, will have to establish that it is a major and not a secondary phenomenon. Were this to be ascertained, the small business will be defined by qualitative criteria, which are reserved for major phenomena only.

CONCLUSIONS: According to the Equilibristic Decision Making System (EDMS) a small business is a secondary phenomenon which should be defined with quantitative criteria.

To win converts to the contradictory argument, that small business is of major importance, is a difficult task though not an impossible one. It is difficult because the opinion of the defined, the small business itself, is immaterial to the definer. That the defined assesses itself as a major phenomenon bears little on the definer, whose assessment is the only one that counts.

(v) Weightedness of Criteria, Indicated by Their Ordered Position

Most definitions use more than one criterion to describe a defined, and usually all of them are expected to be complied with. Because of their equal compliance requirement, all such criteria are considered to be

of equal ranking. The question arises whether, in the case of two definitions which use identical criteria to define the same defined, but have each placed the criteria involved in a different order, thus creating an "asymmetric fit" between their respective definitions, the criteria used will still be of equal weight, despite their "asymmetric fit".

An example of a juristic definition, where the order of the qualifying elements indicates the weight attributed to each by the legislator, is that of the UK limited private company, as originally defined by the **Companies Act 1948.** The Act did not define a limited private company in one inclusive paragraph, but in stages, located in the Act according to a weighted value. The five requirements specified in the Act - incorporation, limitation of liability, restricted share transfer, maximum of 50 shareholders,[3] and non-issuance to the public - appeared in that mentioned order.

Incorporation, the first requirement, appeared in the title of Part I of the Act, the heading of section 1 and paragraph 1(1).[4] Limitation of liability was mentioned second, in the last words of section 1, paragraph 1(1) and in paragraph 1(2).[5] And the last three requirements - restricted share transfer, maximum of 50 shareholders, and non-issuance to the public - appeared last in section 28 of the Act.

Incorporation was mentioned first, since it was the most essential requirement of the definition, without which none of the other requirements could materialise. Tom Hadden[6] considered that "The basic distinction in

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3 The Companies Act 1980 has altered the requirements of the 1948 Act in respect of the limited private company by deleting the requirement that shareholders be limited to 50.

4 The heading of sec.1 reads: "Mode of Forming Incorporated Company", Para.1(1): "Any seven or more persons ... any two or more persons ... may ... form an incorporated company with or without liability."

5 Secs.2(a), 2(b), and 2(c) enumerated the three forms of an incorporated company:
(a) limited liability of the members for the amount unpaid on the shares held by them,
(b) limited liability of the members by their guarantee to contribute the assets of the company were it to be wound up,
(c) an unlimited company having no limit on the liability of its members.

6 Tom Hadden, Company Law and Capitalism, Weidenfeld and Nicholson, second edition, 1977, p.142.

legal theory between a registered company and other forms of business is the fact of incorporation."

The limitation of liability was the second most important element of the definition. With a few exceptions, where the court lifted the veil of incorporation,[7] which could potentially also erase the limitation of liability, the maxim of limited liability has been respected by the Courts since **Salomon v. Salomon & Co.**[8] It was reaffirmed in **Henry Brown & Son v. Smith**[9] and has not been challenged since. Tom Hadden considered the issue of limited liability to be of "more important consideration than the technicalities of privacy".[10]

The final three requirements for privacy as listed in section 28 belonged to a lower order than the first two, as was indicated also in section 29, which stated that although the non-fulfilment of section 28 requirements could disqualify from some advantages otherwise granted, an explanation and eventual rectification might restore the company to its previous status and advantages. Further proof that section 28 requirements were less important, was the absence of the imperative "must", which appeared in section 2(1) regarding the contents of a memorandum.

Sec.2(1) "The memorandum of every company must state:

a) "... with limited..." [i.e. limited liability]

b) "... whether the registered office of the company is to be situated in England or in Scotland..." [i.e. incorporation]

The imperative "must" does not appear in connection with the privacy of a limited company. Hadden noted that "... the distinction

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7 Bushell v. Faith, 1970 AC 1099; re Westbourne Galleries Ltd., 1972 2 WLR 1289.

8 Salomon v. Salomon & Co., (1897) AC 22.

9 Henry Brown & Sons v. Smith (1964), 2 Lloyds List, 476.

10 Tom Hadden, supra, note 6, p.80.

between public and private companies ... is one of decreasing practical importance."[11]

According to Professor Schmitthoff, the privacy elements of a limited company[12] are not obligatory. This is to say that the restrictions are not enforceable:

> "... i.e. the Act does not require the company in fact to comply with them, nor does it provide that the company shall cease to be a private company if not complying with its articles."[13]

The correlation between the order in which the qualifications for a limited private company appear in the **Companies Act 1948**, and their respective weightedness, provide sufficient proof to suggest that the order in which the legislator introduced the qualifying criteria was not haphazard, and was intended to indicate their order of importance.

It is not, however, an automatic proof that the lower placed criteria do not have to be complied with, or that an asymmetric order of elements in otherwise similar definitions renders them fundamentally different. What the placement order of the criteria within a definition proves is that the legislator attributed to them different weights. Knowing the weightedness of the different criteria in a definition helps to understand and interpret the definition itself.

Conclusion

The technical process of formulating a definition consists of three methods: positive, negative, and exclusive. The positive method is the most straightforward, since it describes the defined in a direct manner which does not leave much scope for interpretations. It is therefore desirable that legal

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11 Ibid., p.121.

12 The Companies Act 1948, Secs.28 1(a),1(b) and 1(c).

13 Prof. C.M. Schmitthoff (ed.), Palmer's Company Law, Stevens & Son, Vol.1, 22nd edition, 1976, p.42.

and juristic definitions should avail themselves of this definition method wherever possible. The negative method defines the defined not according to its intrinsic characteristics, but according to those it lacks. This method is used when it is impossible to use the positive method, because the similarity of the defineds expresses itself in their common deficiencies, rather than attributes. As to the exclusive method of definition, this is used when the defineds display different quantities of identical qualitative characteristics; it is therefore suitable in the definition of secondary defineds, rather than primary ones.

Each of these methods of definition can follow one of two techniques: the subjective or the objective. The role of the techniques is to ascertain that the definition's terminology conveys the intended meaning to all its parties. The subjective technique deals with the actual meaning of the terminology, while the objective one deals with the relationship between that terminology and external factors. The subjective technique is used only when the subjective one fails to establish a fit between the terminology and its meaning.

All the methods and techniques of definitions deal with two types of criteria: the qualitative, which describe the characteristics of the defined; and the quantitative, which enumerate them. The latter criteria are recom mended by the Equilibristic Decision-Making System as suitable for the definition of secondary phenomena, of which small business is one. Criteria are assigned different degrees of importance according to whether they are qualitative or quantitative, and according to their placement within the definition; the earlier the criterion is mentioned, the more important it is deemed to be.

PART TWO

MECHANICS

SECTION A

THE QUALITATIVE DEFINITION

1. The Juristic and Administrative Definitions

CHAPTER FIVE

THE US QUALITATIVE DEFINITION OF SMALL BUSINESS

Introduction

The two countries positioned at the two extremes of the prevailing range of socio-economic systems are the USA, an adherent of the capitalist philosophy, and the People's Republic of China, an exponent of the communist system. It is of special interest to compare their qualitative definitions of small business at this time, when in both countries past opinions and beliefs regarding small businesses are giving way to new ones. In the USA, harsh capitalism has been mitigated by scores of legislative acts and regulations, directed at the curtailment of entrepreneurship for the sake of the protection of the consumer, the environment, and the workers.[1]

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1 William M. Diamond, The Differential Impact of Government Regulation on Small vs. Large Business, A Special Study of Economic Changes, for the Joint Economic Committee of the United States Congress, School of Business, State University of New York, Apr. 1, 1979, p.i:

> "Expansion of Government controls on the private sector has appeared to proceed at a near-exponential rate over the past fifteen years. Much of this impression has been created by the dramatic and costly extension of stringent regulations over the environmental factors affecting business. Another arena of major regulatory growth has encompassed the broad range of terms and conditions of employment. The impact of this second category of regulation on business, in addition to the desired changes in employment practices and job safety, can be measured in the increased paperwork imposed. Legislation fixing standards of environmental contamination, by contrast, often requires substantial incremental capital investment as well as on-going operating costs to support the installations and to remain in compliance."

In the People's Republic of China, fundamental changes in economic thinking are now taking place.[2] Planning, which restricted the scope and existence of small business, has been eased to such a degree that small businesses are actually encouraged.[3] In November 1978, the People's Republic of China (PRC) announced its intention to send a delegation to the forthcoming Sixth International Symposium of Small Business (ISSB), which was due to be held in October 1979 in Berlin, and had also offered to host a meeting of the ISSB in China.[4] Economic philosophy and reality are important influences, not only in the choice of the qualitative criteria

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2 (a) Liu Guoguang and Zhao Renwei, "Theoretical Discussion - Socialist Economic Planning and the Market", Beijing Review, No.31, Aug. 3, 1979, p.12:

> "Differences in production that are caused by the management of an enterprise and not by objective factors should bring different material benefits to enterprises and to their workers and staff... Practice proves that if one puts one-sided stress on regulation by planning and neglects that by the market, one will likely see only the identity of people's fundamental interests, and overlook the difference in their interests, and this is unfavourable to arousing the enthusiasm of the enterprises and the workers and staff..."

(b) "More Job Opportunities", Beijing Review, No. 31, 3.8.79, p. 3:

> "... at present and for a long time to come, collectively owned enterprises [meaning privately owned] should provide most of the jobs. The reason is that with little investment these enterprises can take in a large number of workers, and the advantage is that since they are responsible for their own profits, and losses, the state's payroll will not be affected."

3 "Guidelines for Economic Development in Jiangsu", Beijing Review, No.30, July 27, 1979:

> "Adhere to the principle of combining large enterprises with small and medium-sized ones and walking on two legs. In other words, while building large modern enterprises, the province should actively develop the small and medium-sized ones which are less advanced in equipment and technology at present...Simultaneously develop state industrial enterprises and collectively owned ones."

4 The announcement was made by Siu H. Tim, MD, Director of the Continental Bank, Alhambra, California, who represented the PRC commercial interests on the occasion of the Fifth ISSB which was held in Anaheim, California, USA, on Nov. 15, 1978.

to be used in the definition of small business, but also in the scale of its quantitative ones. An economic philosophy favouring a "free market" economy would tend to promote the owner-manager criterion. And a bullish economic climate would invariably encourage the growth of small businesses. This would then result in the increase of the upper limits of turnover, workers and profit determinants. But a cautious economic climate would limit their growth and lessen their role in the economy, thus decreasing their numbers, size and profitability, and simultaneously the numerical determinants used for their definition.

(i) The Small Business Act 1953, Definition

The USA possesses juristic definitions of the small business, though it does not have a legal one. The juristic definition of the **Small Business Act 1953** (as amended), which is only partially qualitative, can be considered as a semi-legal one, despite the fact that it is basically a juristic definition. It is elevated to a semi-legal status, because it is the most comprehensive US legislation regarding small businesses. Nonetheless, it is not a legal definition in its strict sense, because other definitions of the small business do exist. The only other existing small business definition which used qualitative criteria is that of the **Selective Service Act 1948.** But there exist, however, numerous definitions which used quantitative criteria to define small businesses.

The small business definition of the **Small Business Act 1953** (as amended) Sec.3, reads as follows:

> "... A small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation..."

The essential qualitative elements of this definition are three:

1. Independent onwership.
2. Independent management (operation).
3. A small share of the market.

These three qualitative elements are only part of the definition, which consists of two additional quantitative elements: employment and sales volume. Only compliance with all the qualitative elements, and with one of the quantitative ones, enables a business to benefit from the Small Business Administration assistance programmes and services.[5] The quantitative criteria were introduced in order to ascertain the relative meaning of "small" within each industrial sector.[6]

The preoccupations with a relative size, rather than an absolute one, are a key to understanding the attitude of the USA legislator towards small businesses. The essence of his philosophy is expressed in sec.2(a) of the same Act:[7]

> "The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business and opportunities for the expression and growth of personal initiative and individual judgment be assured."

Sec.2 describes the philosophy, and Sec.3 crystallises it into a definition. The private enterprise of Sec.2 is narrowed and clarified as independent ownership by Sec.3. The elements of "free competition" and the "individual judgment" of Sec.2, can be identified with the "small market share" and the "independently operated" of Sec.3. Although the definition of small businesses as used in the **Small Business Act 1953** (as amended), is just a juristic definition formulated specifically for the

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5 The Small Business Administration (SBA) was created by the Small Business Act Sec.4(a): "In order to carry out the policies of this Act there is hereby created an agency under the name 'Small Business Administration'..."

6 Ibid., Sec.3:

"... In addition to the foregoing criteria the Administrator in making a detailed definition may use these criteria, among others: number of employees and dollar value of business. Where the number of employees is used as one of the criteria in making such definition for any of the purposes of the Act, the maximum number of employees which a small business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and to take proper account of other relevant factors."

7 The title of sec.2 is "Policy of Congress".

purpose of that Act, its influence has spread beyond it, as it has been adopted by other US legislation[8] and has also been followed by other countries. In the UK the Bolton Committee[9] has used the same three qualitative criteria for its definition of the small business, and the Canadians have considered it suitable for their economy.[10]

In order to establish its supremacy, the Act authorised the cancellation of any other existing contradicting definitions,[11] and its hegemony has not been challenged since. The **Small Business Act** was introduced 26 years ago, and the validity of the qualitative criteria it used in the definition of small business has not been disputed. On the contrary, their profoundness has been re-established by the US Congress time and again, whenever the issue of small businesses was brought up.

In November 1976, a House of Representatives Committee on small business once again found that:

> "... The importance of small business in a free enterprise system has been recognised by all Presidents and Congresses dating all the way back to the times of George Washington and Thomas Jefferson."[12]

The Committee declared its implicit support of small businesses:

> "If one believes in private initiative, one must acknowledge the right of small business to exist. Also it must be admitted that the destruction of the opportunity of the small businessman of any given industry to compete inexorably follows the concentration of control of such industry into a few numbers of dominating corporations."[13]

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8 (a) Trade Act 1974 (Regulations), 13 CFR Sec.315.58 p.453.
(b) Small Business Investment Act 1958 (as amended), Sec.103(5).
(c) The Federal Water Pollution Control Act. Amendments of 1972, 33 USC 1151 et seq. and its regulations; 42 FR 8083 Feb. 8, 1977, 40 CFR Secs.21.1; 21.2a.
(d) The Housing and Urban Development Act of 1968, 12 USC 1701a and its regulations, 24 CFR part 135, sec.135.5(b).

9 J.E. Bolton, Small Firms Report of the Committee of Inquiry on Small Firms, HMSO, Cmnd. 4811, 1971, p.3.

10 Rein Peterson, Small Business Building a Balanced Economy, Press Porcépic Ltd., Ontario, 1977, p.63.

11 The Small Business Act 1953 (as amended), Sec.21.

12 Committee on Small Businesses, House of Representatives, 94th Congress, Summary of Activities - Report 1738, Nov. 1976, p.292.

13 Ibid.

Although the above statement, by the US House of Representatives Small Businesses Committee, echoed the same conviction in the USA's capitalistic economic philosophy in general, and in small business in particular, as was voiced in 1958, the reality of the situation had changed.

In theory, the principle of "free enterprise" is as potent as ever. In practice, the regulators have curtailed and circumvented its existence. This has created an anomaly, whereby the theory of capitalism is being preached, and the practice of planning and controlling the economy is being adhered to. In the People's Republic of China the reverse process is taking place. Whereas the principles of Communism are repeated aloud, the practice of the "market" (typical of capitalistic economies) is being allowed to assist in the channelling of the economy.

The **Small Business Act** definition is divided into qualitative and quantitative criteria, each entrusted to another law maker. This division was supposed to combine the advantages of certainty and flexibility, the qualitative criteria being identified with the lasting effects of the main legislation, and the quantitative ones with the changing but flexible administrative regulations. This would have been an attainment of the ideal in legislation - the retention of principle and concept-making by the main legislator, and the relegation of the details, the actualities of execution, to the administrative regulator - but it has not always worked that way in practice. The intention of harnessing the Regulations to the Acts does not always materialise. Often the meticulous planning misfires, reversing the pre-arranged ranking, with the details becoming more important than the principle, and the administrative regulator more prominent than the legislator. The intended adherents to the principles - those businesses actually covered by the Act - are affected more by the fine details of the regulations than by the broad principles formulated in the main legislation. Since details dictate everyday life, they overshadow the principles.

The reality of commercial enterprises is such that the arguments and complaints advanced by US small businesses, in connection with a small business definition, invariably revolve around the justification of a specific numerical determinant. What is contested as inappropriate is the figure of 500 employees, rather than the criterion of employment itself or the principle of independent ownership.[14]

The fact that the validity of the qualitative criteria of independent ownerships and independent operation, as definers of a small business, have not been challenged amight be due to their extensive interpretation by the regulations which were issued pursuant to the Small Business Act.[15]

The regulations have identified "independently owned and operated" with "control", and have dealt with those situations in which the meaning of "control" could have been misinterpreted. For the determination of "control" in affiliated concerns, the regulations have established the following guide-lines.

A concern was deemed to be affiliated to another, and not independently owned and operated when:

1. one concern controlled, or had the power to control another; or
2. when a third party or parties controlled, or had the power to control both concerns.

In determining whether concerns were independently owned and operated, all relevant factors such as common ownership, common management and contractual relationships, had to be taken into consideration.[16] The general assumption is that every business concern had one or more

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14 "Definition of Small Business", within the meaning of The Small Business Act of 1953 (as amended). A report pursuant to H Res. 114, 84th Congress House of Representatives, Report No.2964, Oct. 30, 1956, p.2.

15 Rev. 13.39 FR 44424 Dec. 24, 1974 - 13 CFR 121.3-2.

16 Ibid.: the regulation pays special attention to the ownership of a franchise, and to disadvantaged individuals.

parties, who directly or indirectly were in a position to control it. The power to "control" could take an affirmative, or negative, form, and it was irrelevant if it was actually being exercised, or was merely in a dormant state.[17]

An example of negative control would be a case where a non-managing party could circumvent the actions of the managing party because it held 50% of the voting shares. So although the actual everyday control might be in the hands of one party, the fact that the non-managing party had power to block its actions means that the non-managing party is actually the one that has control. Negative control could also be exercised by a minority shareholder, if the company's articles and memorandum (byelaws of the corporation) were drawn in such a manner as to permit a minor shareholder to censure the majority's proposals.

For the purpose of determining who has the control of a concern, persons with identical interests might be considered as one, if they were related to each other.[18] When the control rests with a corporation, it is deemed to belong to the party which controls 50% or more of the voting shares of the corporation.[19] A party could control less than 50% of the voting shares, and yet be deemed to have effective control, if its shareholding was largest in relation to the other shareholdings.[20]

If the voting shares of a concern are distributed in a manner that its management,[21] directors and officers have between themselves

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17 Ibid., Sec.121.3-2(a)(i).

18 Ibid., Sec.121.3-2 (ii).

19 Ibid., Sec.121.3-2(a) (iii) (a).

20 Ibid., Sec.121.3-2(a) (iii) (b).

21 Ibid., Sec.121.3-2(a) (iii) (c).

less than 50%, and the other 50% are distributed widely, without any shareholder having more than 10%, then the control of the concern is deemed to belong to its management. Control of a concern could also be exercised through stock options, convertible debenture and agreement to merge, and not only through the holding of voting stock.[22]

Another form of control is that exercised through a common management,[23] which has the power to direct the operation of any of the concerns it is involved with. Examples of common management are the interlocking management,[24] where the directors, the officers, the employees or the main shareholders of one concern are an active working majority on the board of directors of another concern; or when two concerns use common facilities[25] such as office space and/or employees, and/or other facilities, especially when these concerns operate in the same, or a related field of business, or where they were previously affiliated. A new concern could also be considered to have a "common management" with another concern if it employs former officers, directors and main shareholders of that concern, who subcontract from their present concern to the former.[26] Joint ventures could also mean "common management" if, for the carrying out of certain contracts, two concerns join financial and managerial resources, without an actual legal incorporation or partnership.[27]

The aspects of independent ownership and operation have been covered thoroughly by the regulations, leaving no ambiguity as to the legislator's aim or meaning.

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22 Ibid., Sec.121.3-2(a) (iv).

23 Ibid., Sec.121.3-2(a) (vi).

24 Ibid., Sec.121.3-2(a) (vi) (a).

25 Ibid., Sec.121.3-2(a) (vi) (b).

26 Ibid., Sec.121.3-2(a) (vi) (c).

27 Ibid., Sec.121.3-2(a) (vii) (b).

(ii) The Selective Service Act 1948 Definition[28]

The Selective Service Act 1948 is the only other legislation, apart from the **Small Business Act of 1953**, which has offered a qualitative definition of small businesses. This Act deals primarily with military service duties and the harnessing of industry to the war effort. Its definition of small businesses is accidental, and must have been prompted by the need to enable them to benefit from the lucrative income of "defence contracts", usually dominated by big concerns. Section 18A of the Act defines a small business as follows:

> "For purposes of this section, a business enterprise shall be determined to be 'small business' if (1) its position in the trade or industry of which it is a part is not dominant, (2) the number of its employees does not exceed 500, and (3) it is independently owned and operated..."

For the definition of small business, the Act has relied on both criteria, the quantitative as well as the qualitative, and has also fixed the former's numerical determinant at 500 employees. In a sense, it is a more comprehensive definition than that of the **Small Business Act**, as it is self-sufficient, and does not rely on the administrative regulator to supplement it with the quantitative criteria and their numerical determinants.

The qualitative criteria of "small market share" and "independent ownership/management", used by the **Selective Service Act 1948** definition, are identical to those used by the **Small Business Act 1953**, which followed it.

Sec.3 of the **Small Business Act 1953** defined small business as:

> "... independently owned and operated and which is not dominant in its field of operation..."

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28 The Selective Service Act, June 24, 1948 was renamed "Universal Military Training and Service Act", on June 19, 1955, by Stat. 75 Ch.44, Title 1, par.1(a), then renamed "Military Selective Service Act of 1967", by Public Law 90-40 Sec.1.(1), and renamed again "Military Service Act", by Public Law 92-129, Title 1, Sec.101(a)(1) on Sept. 28, 1971.

The slight stylistic difference between the two definitions, relates to the phrasing of "market share". While the **Selective Service Act** refers to it in this way:

> "... its position in the trade or industry of which it is part is not dominant...",

the **Small Business Act 1953** (as amended) refers to the same market share as "not dominant in its field of operation". This variance cannot be indicative of any difference except a stylistic one.

That the small business definition of the **Selective Service Act 1948** has not been superseded by the later **Small Business Act 1953** definition, is an interesting isssue, because the latter's section 21 empowered it to repeal inconsistent laws:

> "All laws and parts of law inconsistent with this Act are hereby repealed to the extent of such inconsistency."

That it did not do so is a prima facie proof of its consistency with the **Small Business Act 1953** (as amended) definition. But this opinion did not receive unanimous support. In a preliminary report of the House of Representatives sub-Committee of Government Procurement, Disposal of Loan Activities, [29] it was suggested that Section 18(a) of the **Selective Service Act 1948** should be repealed

> "... in order to remove all remaining doubt as to the definition of 'small business concerns'."[30]

As the qualitative criteria are the same in both definitions, the sub-committee's concern with the doubt which might be created, by the concurrent existence of the **Selective Service Act** definition, could be attributed to one of the two remaining differences between the two definitions. One of these is the quantitative threshold of 500 employees,

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29 "The Small Business Administration and Related Activities", Report to the Select Committee on Small Businesses, House of Representatives, Report No. 1045, July 1, 1955, pp. 7-9.

30 Supra. note 15, p.92.

which is not mentioned in the actual definition of the **Small Business Act 1953** (as amended); and the other is the asymmetric order in which the criteria are mentioned in each of the definitions.

(iii) The Differences Between the Two Definitions

There are three differences between the small business definitions of the **Selective Service Act 1948** and the **Small Business Act 1953** (as amended). The first is the numerical upper limit of employees constituting a small business; the second is the use of the turnover criterion as a size definer, which is used only by the **Small Business Act 1953** (as amended) definition; and the third is the order in which the elements of the definition are given in each definition.

(a) The Numerical Threshold Differences

The **Selective Service Act** definition recognises the existence of only one type of small business - that employs less than 500 employees - while the **Small Business Act** definition is more flexible, in that it tries to match the quantitative numerical restrictions with the qualitative characteristics of each industry.[31] For instance, in some industries it considers an enterprise with up to 1500 employees a small business,[32] while in others a mere 250 is the maximum.[33] Consequently, some industries with more than 500 employees will have lost their small business status originally conferred under the **Selective Service Act 1948.**

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31 Supra, note 6, p.89.

32 The petroleum refining industry is considered "small" as long as its number of employees does not exceed 1500: Schedule A, Employment Size Standards for Concerns Primarily Engaged in Manufacturing, Rev. 13 39 FR 44424, Dec. 24, 1974, as amended by Amdt. 6, 40 FR 50519, Oct. 30, 1975.

33 In the mining industry, the lowest employment limit is 250 employees: Schedule F, Employment Size Standards for Concerns Primarily Engaged in Mining and Mining Services, Rev. 13, Amdt.40 FR 51033, Nov. 7, 1975.

It could be argued that although the numerical determinants of the employment criteria are not identical in both definitions, their variance is only a matter of detail, and not of essence, and therefore the **Selective Service Act** definition is not affected by Sec.21 of the **Small Business Act 1953**, which set out to repeal only inconsistent legislations, involving difference in substance and not just in detail.

The Sub-Committee on Procurement, Disposal and Loan Activities to the Select Committee on Small Business[34] did not agree that the difference between the definitions was only one of detail. And they persisted in their efforts to abolish the **Selective Service Act** definition. When their suggestions of 1955 were not accepted, they repeated their demands in the following year.[35] The fact that the Committee was determined to establish the supremacy of the **Small Business Act** definition supports the claim that the difference between the two definitions was one of substance and not just of detail. However, it is not feasible that their differences as regards number of employees is the "inconsistency" referred to in Sec.21 of the **Small Business Act 1953** (as amended), because, as mentioned, even within the Size Standard Regulations of the **Small Business Act** itself, there are differences in the numbers of employees specified.

Alternatively, it could be argued that the "inconsistency" between the two definitions is due to the different weight attributed to the employment criterion by each of them.

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34 Supra, note 29, p.96.

35 Report of the Sub-Committee No.2 on Government Procurement, Disposal and Loan Activities to the Select Committee on Small Business. House of Representatives Report No.2964, Definition of Small Business within the meaning of the Small Business Act 1953 (as amended), Oct. 30, 1956, p.2.

According to the **Selective Service Act 1948**, an applicant which exceeded the 500-employee threshold would be rejected, because compliance with that determinant is an implicit condition of the definition. Yet, if the same applicant applied to be included in the small business definition of the **Small Business Act 1953**, he might be accepted despite his deviation from the determinant of the 500 employees, because compliance with an employment determinant is not an implicit condition of the **Small Business Act** definition.

It might be argued that without the regulations that decide the numerical determinants, the Act's definition is incomplete and meaningless, and therefore compliance with the regulation is an implied condition of the Act's definition. Yet such an argument ignores the fact that an Act is ranked above its Regulations and is therefore independent from them. Consequently an applicant who complies with the conditions set out in the Act's definition of small business is entitled to small business status, though he will not be entitled to the benefits of the specific assistance programmes which are authorised by the Regulations, because those are linked directly with the Regulations' numerical determinants.

The Act did not state that the employment criterion is a condition of the definition, but suggested it as an administrative aid:

> "In addition to the foregoing criteria the Administrator, in making a detailed definition may use these criteria among others: number of employees and dollar volume....."[36]

In other words, the employment criterion is not an imperative

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36 Supra, note 6, p.89.

condition and therefore it is only regulatory in nature,[37] and as such, non-compliance with it does not automatically cancel the small business status of an applicant.

(b) The Turnover Criterion

In addition to the employment criterion, the **Small Business Act 1953** has also used a sales-volume (turnover) criterion for the definition of small business; whereas the **Selective Service Act 1948** used only the employment criterion.

As a result of using different criteria to define small businesses, industries which the **Small Business Act** Size Standard Regulations considered as "big" according to their sales-volume[38] determinant could be considered to be "small" according to the employment criterion of the **Selective Service Act 1948.** This difference in the types of qualitative criteria used by the two definitions also cancels the claim that the variance between them was only in respect of employment.

(c) The Assigned Order of the Definition's Elements

Although the apparent elements of the two definitions are identical, their assigned order is asymmetrical. In the **Selective Service Act 1948**, they appear in the following order:

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37 This argument is based on a comparison with section 28 of the UK Companies Act 1948, which restricted the activities of a private company, yet did not abolish or penalise those companies which did not comply with these requirements. Prof. Schmitthoff was of the opinion that these requirements were therefore only regulatory in nature, and non-adherence to them did not automatically cancel all private company privileges. Prof. Schmitthoff (ed.), Palmer's Company Law, Stevens & Sons, 22nd edition, 1976, Vol.1, p.42.

38 Among the industries whose small size is determined according to a turnover criterion, are: the wholesale trade in durable goods, such as car sales, home furnishing sales, sporting-goods sales, metal service centres, electrical apparatus and equipment sales; the wholesale trade in non-durable goods, such as: printing and writing paper, drugs, woven fabrics, footwear, frozen foods; the retail trade; and the mail order trade. (Rev. 13 Amdt. 5 40 FR 32826 Aug. 5, 1975.)

1. Small market share;

2. Number of employees;

3. Independent ownership/management.

But in the **Small Business Act 1953** (as amended), they appear in the following order:

1. Independent ownership/management.

2. Small market share.

3. Number of employees or sales volume.

In both definitions the three requirements are interdependent, and only their total satisfaction results in a qualification. The fact that the criterion of "independent ownership/management" is the first requirement of the **Small Business Act 1953**, but the last one in the **Selective Service Act 1948** definition, is significant. It demonstrates the different attitudes of the two legislators towards the function of small business in the economy and community at large.

(d) Competition – The Hidden Element of the Definition

The Small Business Act definition considers "competition" as the raison d'être of small businesses. Competition expresses itself in a multitude of independent owner/managers; hence, also, the insistence on independent ownership and independent management as distinct from a mere combination of ownership/management.

Section 2(a) of the Act states this clearly:

> "The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation...It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise..."

In the USA small business is entrusted with the mammoth task of upholding not just the economic and social balance of the country but also its security. All this is achieved through "competition", which can

survive only due to the existence of small businesses. Concern for small business has been a feature of American history.[39] Americans fear that economic power is political power. Judge Learned Hand[40] in **United States v. Aluminum Company of America** wrote:

> "It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few."

Smallness is not being portrayed only as an economic fact of reality, it is elevated to a way of life which should be cherished. A quote from the Final Report of the Select Committee on Small Business in 1952, prior to the approval of the **Small Business Act 1953**[41] reads:

> "... no business should be considered "small" which is strictly not competitive. Dominant firms, concerns tied to larger units, and affiliated plants should be excluded. Public concern must be extended to the independent firm as well as to the small firm."

Had the American approach to competition been merely a rational economic one, as a controller of prices and quality of products, it might have been possible to relegate the independent owner/manager element of the small business definition to a secondary position, and promote instead the small market share element, which is easier to ascertain than the independence element. But the Americans have elevated the concept of competition onto such a high pedestal that it had to be personified in the flesh and blood of the independent owner/manager - the small man, the modern David of the business battlefield, against Goliath.

When the continued existence of a small business becomes a matter of national security, rational and factual criteria cease to be relevant. The fact that it has 500 employees, 1000, or 1500 employees; or that its sales

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39 Addison W. Parris, The Small Business Administration, Frederick A. Praeger, New York, 1968, p.v.

40 United States v. Aluminum Company of America, Vol.148, Federal Reporter 2nd Series 416 (2nd Judicial Circuit 1945) p.427.

41 Report No.2513, House of Representatives, Review of Small Businesses, p.5.

volume is counted in millions of dollars; or that it employs the latest marketing, production and accountancy technologies, does not detract from its small business status, as long as it is independently owned and managed. This is because the emphasis is on creating a competitive market, which existence depends on the availability of a large number of independent buyers and sellers. The definition of the **Small Business Act 1953** is essentially an ideological definition: that is, one which defines the defined not according to what it is and how it functions, but according to what it should be, and how it should function. And in order to create an apparent symmetry between what the defined should be and what it is, the definer manoeuvres the defined's externalities to accommodate themselves to the role he allocates them, and not conversely.

The dictum that "smallness" is a relative variance and not an absolute parameter is readily accepted, as it is basically not incorrect. What is overlooked, however, is that it is not a law of nature that smallness exists everywhere. Certain industries are big. They are big according to all possible measurement criteria barring one: that of competition. They have big capital investment, big sales, big profits and large numbers of employees. That some other business, in the same industry, is bigger does not necessarily mean that they are small.

The fact that in certain industries there are no small businesses was accepted in the UK by the **Industrial Training Levy Orders.**[42] Small businesses were exempted from the levy, in industries where they existed. Where they did not exist, as in the man-made fibre industry, it was not felt that they should be invented by using a "size relativity" criterion. They were simply not exempted, because they did not exist in the first place.

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42 The Man Made Fibre Industry Training Board has not exempted small businesses from the levy, because according to the prevailing definition of small business (that of the Bolton Report), no such business existed within the man-made fibre sector.

The **Selective Service Act 1948**, in contrast with the **Small Business Act 1953** (as amended), relegated the independent ownership element to the last position, in its definition of small business, because the Act was concerned with facts and not ideals. Its Chapter 1 Section 1 outlines its policy:

> 1(b) "The Congress declares that an adequate armed strength must be achieved and maintained to insure the security of this Nation."

Section 1(e) deals with the utilisation of industry for security efforts

> "The Congress further declares that adequate provision for national security requires ... the fullest possible utilisation of the Nation's technological, scientific and other critical manpower resources."

Section 18 of the Act deals with the utilisation of industry in the security effort; the procedure of placement of orders; precedence of Government-placed orders; and failure to give such precedence.

Small business is mentioned in Section 18(a), in the following context:

> "... Under any such program of national procurement, the President shall recognise the valid claim of American small business to participate in such contracts, in such manufacture ... and small business shall be granted a fair share of the orders placed, exclusively for the use of the Armed Forces..."

The Act was concerned fundamentally with national security. The interests of small business were imposed on it for political reasons, so as to let small business share in Government contracts. Consequently, its definition of a small business is a realistic one. The definer defined what is, and not what should be. To the **Selective Service Act** definer, small business manifested itself primarily as one which had a small market share, and a maximum number of 500 employees. The fact that it was also independently owned and managed was seen to be a result of the previous criteria.

(e) The Selective Service Act 1948 v The Small Business Act 1953

The conclusion reached from the comparison of the two definitions

is that the **Selective Service Act 1948** definition of small business is inconsistent with the **Small Business Act 1953** definition, and should therefore be nullified by Section 21 of the **Small Business Act.** This conclusion is based on the foregoing observations:

1. That the **Selective Service Act** definition lacks one element, that of turnover, which is included in the **Small Business Act** definition.
2. That the differences between the employment determinants represent an inconsistency of substance, and not only of detail, because the reason for that variance stems from the different approach each Act has towards the small business. The **Small Business Act** regards the small business as the upholder of competition, whereas the **Selective Service Act** simply contains a factual definition of a "small" enterprise.

Conclusion

Definitions are phrased in laconic style (or else they become essays), and so they invariably breed interpretations as to their actual meaning.

The following are the conclusions as to what is meant by "a small businesss" in the USA:

1. A small business does not necessarily have to be owned by a private indivdiual, because the condition of "independent ownership" is interpreted widely to include majority shareholders and public quoted companies.
2. The management of the small business need not be exclusive to its owner, because the requirement for "independent operation" concerns "control" in a wider sense than the day-to-day management duties. And as the "control" stems from the ownership rights, the actual management duties could be undertaken by hired managers who do not have ultimate control of the business.

3. A small business does not have to be small in absolute terms, but only in relation to other enterprises within the same field of operation. Consequently what is considered by the **Small Business Act** to be a small business might in real terms be a big one.

CHAPTER SIX

THE PEOPLE'S REPUBLIC OF CHINA

QUALITATIVE DEFINITION OF SMALL BUSINESS

Introduction

The People's Republic of China does not have an official qualitative definition of small business. That is not to say that small businesses do not exist there. In fact many countries, with more consistent economic and political policies than those of China, do not possess a qualitative definition of small business either. To say that an official definition of small business does not exist in China is not to say that the Chinese administration does not hold a definite opinion as to which businesses are considered small. This is apparent from the contents of the various news items, which are channelled into the English-language publications of Beijing (Peking). Official opinions have not yet crystallised into actual legislation or a definition - a phenomenon which should be viewed in the context of the totality of the Chinese attitude towards the formalisation of written law.

Law, as known in the Western capitalist countries - either as legislated codes, as in the civil law countries, or as jurisdictional guidelines, as in the common law ones - has not been part of the Chinese legal tradition.[1] For 30 years after the Communists assumed control in 1949, a population of 900 million people did not conduct their lives according to written rules and regulations. Until July 1979, when the first seven laws were promulgated, all Chinese jurists pointed to one seminal document, from which all the law flowed:[2] Mao Tsetung's 1957 speech "On the

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1 Daniel J. Hoffheimer, "Law and Modernization in China. The Juridical Behavior of the Chinese Communists", Journal of International and Comparative Law, Vol.7, 1977, p.518.

2 Martin Garbus, "Justice without courts, a report on china today", Judicature, Vol.60, No.8, Mar. 1977, p.396.

Correct Handling of Contradictions amongst the People".[3] The speech was first delivered at the 11th Session of the Supreme State Conference, and was then edited for publication by Mao himself. It was published in the **People's Daily** newspaper on June 19, 1957. This talk incorporated Mao's attitudes to issues raising contradictory opinions: from the question of eliminating counter-revolutionaries to the question of industrialists and businessmen, and the running of the economy. The essence of this talk, plus the centuries-old Chinese non-legal dispute-solving mechanism, combined to create the new revolutionary legal system of China.

Arthur Stahnke, in his essay "The Background and Evolution of Party Policy on the Drafting of Legal Codes in Communist China",[4] divided legal development in China since 1949 into three phases. The first phase included the period 1949-1952, in which demands for a stable system, with complete legal codes, were rejected by the official sources, on the grounds that these demands were expressed by people who did not consider the conditions at that time which made such a task impracticable.

During the second phase, 1953-1957, there was a general view that something ought to be done about the lack of basic laws. The third phase, after 1957, expressed actual opposition to those who demanded a written law:

> "Those who advocate the writing of law codes do not consider what our country actually needs. They insist on producing subjectively and formally, a so-called complete system which amounts actually to reducing our laws to a rigid system. Thus, this view does not accord with the spirit of permanent revolution. We must oppose it ... In order that the legal system may be earnestly carried out and in order to enhance the positive attitude and

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3 Mao Tsetung, Selected Works of Mao Tsetung, Foreign Language Press, Beijing, first edition, 1977, Vol.5, pp.384-419.

4 Arthur Stahnke, "The Background and Evolution of the Party Policy on the Drafting of Legal Codes in Communist China", The American Journal of Comparative Law, Vol.15, 1967, p.506.

creativeness of the local areas and the masses, our Party has always insisted on the combination of principle with flexibility in legal work or in any other work."[5]

The third stage lasted until July 1979, when the first legislation - apart from several intermediate constitutions - was enacted. The National People's Congress issued seven orders between the 4th and 8th July, 1979, promulgating seven laws, which were adopted at the Second Session of the Fifth National People's Congress.[6] The seven laws are:

1. **The Organic Law of the Local People's Congress.**
2. **The Electoral Law for the National People's Congress and Local People's Congress.**
3. **The Organic Law of the People's Courts.**
4. **The Organic Law of the People's Procuratorates.**
5. **The Criminal Law.**
6. **The Law of Criminal Procedure.**
7. **The Law on Joint Enterprise Using Chinese and Foreign Investment.**

The last law became effective on the day of promulgation, while the others came into force in January 1980.

In a social and political climate where legal or juristic definitions did not exist, and did not matter, it would have been preposterous to expect to find the administrators concerned about the details of a small business definition. The influence of the recent changes in attitudes towards legal regulations can be found in the new approach towards small business. A commentary in the **Beijing Review** in July 1979[7] stated, that although State-owned enterprises were the backbone of the nation's industry, collectively owned enterprises were also an important force

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5 Ibid., p.507, quoted from a speech by Tung Pi-Wu, Eighth National Congress of the Communist Party of China, Beijing, 1956.

6 "Publicizing the New Laws", Beijing Review, No.29, July 20, 1979, p.3.

7 "Collective Ownership Bright Prospects", Beijing Review, No.28, July 13, 1979, p.4.

which could not be overlooked. The characteristics of collectively owned enterprises were described as follows:

> "1. Most of them are small or medium-sized enterprises. Built with little investment, they have gone into production at a relatively fast speed and have yielded quick results.
> 2. Based on the system of independent accounting, they are responsible for their own profit and losses. Since poor or good management directly affects their own interest, the people working there have rid themselves of the 'iron rice bowl'[8] mentality which is harmful to raising efficiency.
> 3. They have the advantage of being flexible in production, and readjustments can be easily made to meet market needs."[9]

This qualitative definition of small business has equated collective ownership with what is considered small business in the capitalist economies. Although this qualitative definition is not an official one, in the sense that it was not sponsored or authorised by any legal institution or administrative department, it could be considered and accepted as one, owing to the acknowledged fact that the information funnelled by the official Chinese publications such as the **Beijing Review** represents the prevailing official attitude on a given issue.

This Chinese qualitative definition differs in its elements from the American one. In order to find out if the two definitions are essentially different - because they have defined two different defineds, or because they have attributed different characteristics to the same defined - it will be necessary: first, to analyse the attitudes of the People's Republic of China towards the elements of the US definition of small business, being those of independent ownership, independent management, and a small market share; and second, to analyse the elements of the Chinese definition independently of those of the US one.

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8 "Rice bowl" is in Chinese the synonym for "job" and "wages". An "iron rice bowl" means a secure job and guaranteed income, irrespective of one's efficiency and attitude towards work.

9 Supra, note 7, p.109.

(i) Independent Onwership in the People's Republic of China

According to Marxist-Leninist doctrines, the ownership of all means of production is vested in the State. This applies to land and industrial ownership alike. This doctrine eradicates any private ownership by individuals of anything that might be interpreted as "means of production".

Since the Russian Revolution, the declared aim of the Soviet Union and all other member states of the communist fraternity has been to eliminate any remnants of private individual ownership of the "means of production".

When examples are pointed to, showing that in more lenient member states such as Yugoslavia and Poland there exists a certain measure of limited (size and numbers) private ownership, these lapses are excused by the countries themselves, and by the stricter member states, as a temporary economic measure which will disappear: all ownership will revert to the State once an economic solution has been achieved.

The attitude of the People's Republic of China to private individual ownership, was expressed by Professor Hazard in 1969, in the following words:

> "Certainly individual farming and private ownership have no place in the Chinese Communist program, as they have in Yugoslavia and Poland."[10]

In 1969 it seemed that the Chinese were not going to use the pretext of a failing economy, and restore a certain degree of private ownership. By then they had managed to eliminate industrial private ownership in the traditional capitalistic sense, leaving only village handicrafts as a supplementary sideline.[11] It took 20 years, from 1949 to 1969, for the elimination of private ownership of industry to be accomplished.

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10 John N. Hazard, Communists and Their Law, The University of Chicago Press, 1969, p.169.

11 Ibid., p.179.

The attitudes of the 1978 Constitution of the People's Republic of China towards private ownership are expressed in Article 5 of that Constitution:[12]

> "There are mainly two kinds of ownership of the means of production in the People's Republic of China at the present stage. socialist ownership by the whole people and socialist collective ownership by the working people."

By "ownership by the whole people" is meant State-owned farms and industrial enterprises; and by "socialist collective ownership by the working people" is meant worker-owned co-operatives. The continuation of Article 5 reads:

> "The state allows non-agricultural individual labourers to engage in individual labour involving no exploitation of others, within the limits permitted by Law and under unified arrangement and management by organizations at the basic level in cities and towns or in rural areas."

The only type of private ownership of industrial means of production which the State will tolerate is personal ownership of one's own ability to produce. The lowest unit of "means of production" is the individual himself, the actual producer - the labourer. It seems that the State has conceded to the individual's right over his own physical being, and allowed him to work individually, as a single production unit. But even this concession is restricted and conditional to:

(a) "...non-exploitation of others..." Exploitation, according to the Communist doctrine, manifests itself in the employment of others. The non-agricultural labourer is allowed to become self-employed, but is not allowed to employ others, in the sense of creating employer-employee relationships.

(b) "... within the limits permitted by organisations at the basic level, in cities and towns, or in rural areas..." The second condition

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12 Keesing's, Contemporary Archives, Sept. 8, 1978, p.29, 185.

imposed on self-employment requires permission by "the organisation at the basic level", this consisting of the resident committees in towns and villages, which are manned by local activists, rather than by Party cadres.[13] Their task is to regulate and supervise each and every activity of each person within their territory. They have the power to forbid an individual from pursuing a career as a self-employed. The restriction imposed on self-employment renders "individual work" a concession rather than a right.

The last paragraph of Article 5 reads:

> "At the same time it guides these individual labourers step by step onto the road of socialist collectivization."

This last paragraph is intended for those few, who escaped the pitfalls of the second paragraph, and have managed to become self-employed. Though from a legal point of view they have not violated the requirements of Article 5, from a moral outlook they have been misguided. This exemplifies the blurred boundaries between law and morals in the People's Republic of China. Where legal enforcement is bound to fail, the moral whip is used. It is not clear whether "guide" would mean only moral guidance, in the sense of verbal persuasion, or if it could also take the form of a more constructive guidance in the form of re-education.

Article 7 of the 1978 Constitution deals with the rural areas:

> "... Provided that the absolute predominance of the collective economy of the people's communes is ensured, commune members may farm small plots of land for personal needs, engage in limited household side-line production and in pastoral areas they may also keep a limited number of livestock for personal needs."

Article 7 reaffirms that individual employment is a conditional concession and not a right. The farmer is allowed to farm a small plot of land for his personal needs, on condition that "absolute predominance" is given to the economic needs of the commune. The instances where

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13 Stanley Lubman, "Mao & Mediation:Politics and Dispute Resolution in Communist China", Cal. Law Review, Vol.55, 1967, p.1311.

the commune's priorities would supersede those of the farmer's are numerous: from fulfilling the commune's production targets and participation in public works schemes, to a shortage of seeds and fertilisers, which will first affect the private plot. Thus the concession to cultivate a private plot can easily be obliterated.

By "engage in limited household sideline production", is meant the pursuance of handicraft skills, which the "household" as a family unit can take part in. This occupation is intended for the old, sick and too young to work, who are not fully utilised in the more physically demanding tasks of the commune. But even this type of occupation, which is not in competition with the commune's, is tolerated only to a "limited" extent. The "limited" condition applies in the following manner. Where a certain private sideline is seen to be succeeding, and a market demand has been created, the commune steps in and takes over the production and the marketing itself. And when the commune decides to take over a handicraft sideline, the individual has to cease his private efforts.

The restrictions which apply to the agricultural workers would also apply to those engaged in the pastoral areas. An article from the **Guangming Daily**, quoted by **Xinhua News Agency** as recently as Apr. 1, 1979,[14] reaffirms the Chinese attitude to self-employment:

> "China, with its socialist system, has a unified planned economy. People do not work as individuals, or for a certain group, but for the whole people."

How further from the American spirit of free enterprise can these restrictions on self-employment be? Until the present liberalisation of restrictions on private ownership, which started gradually at the beginning of 1979, and gained momentum by September 1979, any bud of private enterprise was viewed with suspicion, and considered a deviation from State

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14 Xinhua News Agency, news item 040114, Apr. 1, 1979, p.13.

policies. Private enterprise was permitted only in extenuating circumstances, when it might have supplemented the national economy, or boosted the people's level of production.

The first liberalisation of private ownership took place in the rural areas, which until today engage some 80% of China's workforce[15] in agricultural production. A special fund of 100,000 (£28,000) yuan, at low interest rates, was allocated for loans to peasants by the People's Bank of Jingxian County, Anhui Province, to help develop household sideline production. The county has also rehabilitated those persecuted by the Gang of Four for running sideline production,[16] and drafted working regulations for the Rural People's Communes which were being implemented throughout the county: these regulations stated that household sideline production by commune members was a necessary adjunct to the socialist economy.[17] In addition to the private ownership of small agricultural plots, the marketing and supply for these sidelines have been undertaken by supply and marketing co-operatives. These co-operatives are viewed favourably by the Government, as they are considered to "have become an important bond, linking the State socialist economy with the rural socialist collective economy and linking the town and countryside."[18] Co-operatives, which in the strict legal sense are private ownerships, in contrast to State ownership, have been considered by the Chinese as a stronghold against capitalism, although in reality the co-operatives do not belong to all the people, but only to their members.

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15 "Re-adjustment Will Aid Modernization", Xinhua News Agency, news item 060630, June 7, 1979, p.3.

16 "Peasants' Domestic Sideline Production Stimulated", Xinhua News Agency, news item 050201, May 2, 1979, p.12.

17 Ibid.

18 "Role of Supply and Marketing Co-Ops in China's Rural Economy", Xinhua News Agency, news item 070719, July 7, 1979, p.21.

The second economic sector where private ownership has been revived and encouraged is the handicraft industry. As these industries rely on a low capital outlay, they are seen at the moment as the solution in combating spreading unemployment, and ensuring the supply of varied consumer goods - both of which are topical issues in the People's Republic of China. A report in the **Worker's Daily** of May 31, 1979, dealing with this subject, commented: "In a country like China which has a big population and limited finances, co-operatively owned handicraft and service agencies should exist alongside State-owned modern industry for a long time."[19]

This report has also stated the presently current official line on ownership and remuneration:

> "Because these co-operatives strictly implement the principle of 'each according to his work', and take sole responsibility for their profits and losses, the workers and cadres are highly motivated to increase production, and this in turn benefits the State through taxes."[20]

Since the beginning of April 1979, more than 100 service centres have been set up in Beijing. These include the making and repair of furniture, the repair of television and radio sets, the sharpening of knives and scisssors, hand-knitting, home repairs and house-painting, popcorn stands and small inns, pubs and tea-houses; all of which are privately owned enterprises. Thus not only the young are directed into private enterprise, but also the retired are encouraged to follow suit. Two hundred handicraft shops headed by retired artists were set up in the first five months of 1979.[21]

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19 "Young People Find Work in Expanded Beijing Handicraft Service Trades", Xinhua News Agency, news item 053111, May 31, 1979, p.13.

20 Ibid. The example given by the news item is of the profitability of a small knitwear workshop, which had a gross turnover increase of 649,000 yuan from January to April 1979, the profit on which amounted to 69,000 yuan, and the taxation to the State was 75,000 yuan.

21 Ibid.

In the handicraft industry, State- and collectively owned enterprises are co-operating and existing side by side.[22] The right of the co-operative owner/owners to higher remuneration than that gained by the employees of State-owned industries was recognised officially in the middle of 1979. In the National People's Congress, on June 19, 1979, Premier Hua Guofeng rejected the former stipulation that the wages of workers in collective undertakings could not exceed those of similar workers in State enterprises. He dismissed this old dictum as unreasonable, and said that if workers in collective undertakings created more wealth, they were entitled to higher wages.[23]

The re-introduction of private ownership in the handicraft industries can be confirmed by observing the issue of licences to some 300 handicraft and repair servicemen, after 13 years of suspension, by the Municipal Bureau of Industry and Commerce in Beijing.[24] In justifying his action, the Chief of the Bureau's Enterprise Registration Division has quoted the Chinese constitution as allowing non-agricultural individual labourers to engage in individual labour involving no exploitation of others.[25]

By the end of 1965, there were over 2,200 registered individual handicraft and service workers in the city. But in the following 10 years, 90% of their businesses were banned, or merged with State-owned enterprises. This clean-up operation was considered to have eliminated the "tails of capitalism". The new regime has re-instated and reintroduced, if not all, at least some of the former individually operated

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22 "More Consumer Goods in Shanghai", Xinhua News Agency, news item 060811, June 8, 1979, p.16.

23 "Premier Hua joins National People's Deputation from Beijing in Discussion", Xinhua News Agency, news item 062005, June 20, 1979, p.3.

24 "Individual Handicraft and Service Business Restored in Beijing", Xinhua News Agency, news item 100807, Oct. 8, 1979, p.15.

25 Ibid.

trades and skills. Since the beginning of 1979, the city of Beijing has endeavoured to supply the artisans with the raw materials needed for the exercise of their crafts.[26] The supply of raw materials had always been the key to the control, or rather the elimination, of private enterprise in an orderly manner, without the need to resort to forceful measures. Without a free supply of raw materials, the free markets could not function.

The third sector where private ownership, mainly in the form of collective ownership, has been re-introduced, is the service industry. In Hangzhou, a well-known beauty spot in East China, over 30 neighbourhood hotels under collective ownership were established in the early months of 1979, supplying some 1500 beds.[27] Services such as photography have organised themselves into co-operatives, and have become more successful than the State-owned ones.[28] In Beijing several hundred new collective catering enterprises supplying tea, dumplings, and miscellaneous goods to commuters, have been set up since April 1979.[29]

The revival of private ownership, hitherto repressed, called for explanation and justification by the regime. In resolving the contradiction between communism and private ownership, the regime pointed out that the constitution of China stipulated that both collectively owned and State-owned enterprises were socialist in nature, and should be treated equally; and that the right of ownership of the collective enterprises rests with those working there.[30] The ultra-left line, pursued by Lin

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26 Ibid.

27 "Collectively Owned Neighbourhood Hotels Established in Hangzhou", Xinhua News Agency, news item 070211, July 2, 1979, p.18.

28 "Beijing Newspapers Call Support for Co-operative Enterprises in Cities", Xinhua News Agency, news item 071406, July 14, 1979, p.15.

29 "Beijing Young People Organise Collective Enterprises", Xinhua News Agency, news item 092313, Sept. 23, 1979, p.17.

30 "Collectively-Owned Enterprises Have Great Vitality", Xinhua News Agency, news item 073001, July 30, 1979, p.4.

Biao and the Gang of Four, whereby collectively owned enterprises were considered as "semi-socialist" or "remnants of capitalism", is presently being strongly criticised. Their hostile attitude to private ownership, which has hampered the latter's growth and has brought some of it to the verge of bankruptcy, is considered to have slowed the economic growth of the country.[31] Presently it is being urged that the State- owned and the collectively owned enterprises should be treated politically and economically as equal.[32]

The argument that collectively owned enterprises were socialist in nature had also been expressed by the **People's Daily** newspaper on August 4, 1979. The commentator's article claimed that, since their means of production were owned collectively, and the workers worked together, and were paid according to their labour without exploitation, it was essentially a socialist enterprise.[33] The article conceded that for some time yet the urban collective form of ownership was going to co-exist with ownership by the whole people, as an indispensable component of a unified socialist economic structure.

Approval of the collectively owned enterprises has also come from Tie Ying, the chairman of the Revolutionary Committee of Zhejiang Province. He noted the people's tendency to think that the drive for socialist modernisation will manifest itself only in the erection of large factories, large hotels and large shops; and that everything will be operated by computers; and that small factories and shops, and in particular that collectively run units were looked down upon, and regarded as temporary undertakings soon to be placed under State ownership. He warned those who regard the individual economy as capitalistic and due for elimination

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31 Ibid.

32 Ibid.

33 "'People's Daily' Stresses Importance of Collectively Owned Enterprises in China's National Economy", Xinhua News Agency, news item 080411, Aug. 4, 1979, p.4.

that this was not going to take place, since the increase in unemployment and the lack of variety of products on the market were due to the mismanagement of the economy by the Gang of Four, who over-concentrated production by insisting on the existence of large State- owned enterprises only.[34] Tie Ying also stated that ownership by the whole people co-existed with collective ownership, and was supplemented by individual ownership. He called for a measure of competition among the shops, including State- and collectively owned ones, in order to break the monopoly of State-owned commercial enterprises.[35]

The **People's Daily** urged the development of non-State-owned enterprises side by side with State-owned ones. In an article dated September 6, 1979, the history of private ownership was recalled, from 1957 when there were some 40,000 private enterprises to Lin Biao's rule, when they were reduced to a mere 14,000 according to a 1978 count. The paper stressed the point that collective organisation is part of public ownership, without the exploitation of hired labour.[36]

Much as the People's Republic of China tries to camouflage the resurrection of private ownership, and disguises it as quasi-public, it is apparent that private ownership has been re-introduced. That it is not the only, or major, method of ownership as is the case in the USA, is only a question of degree. There are also countries which belong to the Western free economies, where the extent of private ownership does not compare with that of the USA. The United Kingdom, France and Israel are only a number of examples of countries in which, though on the whole there is a

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34 "Zhejiang Provincial Spokesman Advocates Expanding Urban Collective Undertakings", Xinhua News Agency, news item 081814, August 18, 1979, p.18.

35 Ibid.

36 "'People's Daily' Urges Development of All Sectors of the Socialist Economy", Xinhua News Agency, news item 090607, Sept. 6, 1979, p.3.

free economy, yet the State owns and controls a large section of its industry. In this respect, the new developments in the People's Republic of China have aligned China with them. If the present trend of the relaxation of the exclusiveness of State ownership is allowed to continue and expand, there is a possibility that China could be counted among those countries practising a mixed economy, whereby the State controls the major and heavy capital means of production, and individuals control the handicraft, light industry and service industries, which are all small in nature.

In the light of the present economic and political trends in the People's Republic of China, it can be said that the element of private ownership which was stipulated by the US **Small Business Act** as a means of identifying small business could also be accepted by the People's Republic of China of late 1979. Whether this trend continues is still to be seen.

(ii) Independent Management in the People's Republic of China

The second element in the small business definition of the USA **Small Business Act** is "independent management". Whereas ownership is a tangible concept, a right which can be registered, quantified, measured and inherited, independent management is an elusive concept, and difficult to verify. Whether a manager uses his own judgement is impossible to ascertain. What can be checked, however, is that he has no commitments to financiers, shareholders or suppliers, of such a nature that it might inhibit his independent management. In other words, this means that his range of action is free of encumbrances which might limit his freedom of management.

References to independent management in China will mean the independent management of socialist, co-operative or nationally owned

"means of production". A manager of a Chinese "nationally-owned" factory will be considered an independent manager, if the everyday running of the production and workforce is left to his discretion. Excluded from his scope of decision-making would be those decisions which, owing to the nature of public ownership in a planned economy, are made centrally. He would be expected, however, to decide on the allocation of tasks to the workforce, technical aspects, economic management and expenditure priorities, within his assigned territory.

The concept of independent management has undergone several transformations since the Communist takeover in 1948. The fundamental Communist concept - that management is part of the "Communal Triangle", which consists of communal ownership, communal decision-making, and communal distribution of proceeds generated by the means of production - did not leave much room for independent manage ment. Besides, the theoretical prospect of the withering away of the State, and of any authoritative rule from above, and its replacement with self-government of the people, was not conducive to the development of independent management.

In the 1950s, the People's Republic of China emulated the "one- man management" system as introduced and practised by the Russians.[37] This system was a contradiction of socialist principles. It was introduced in order to boost the low productivity levels reached under more democratic managements. The system, also called the "individual", system, was rejected in 1956, and replaced by a system referred to as "factory manager responsibility, under the collective leadership of the Party committee." The manager[38] was responsible for the implementation of the

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37 Professor Franz Schurmann, Ideology and Organization in Communist China, second edition, University of California Press, 1968, p.253.

38 Quoted by Gene T. Hsiao, "The Role of Economic Contracts in Communist China", Cal. L. Review, Vol.53, 1965, pp.1029, 1049, note 123.

policies which had been dictated by the Party committee, but not for making any policies himself.

The Great Leap Forward movement (1958-59), which was the mass movement to increase production, resulted in the workers' interference in the management's decision making to such an extent, that production was disrupted. During that period, managerial decisions had to be reached collectively with workers, who attended committee meetings instead of the production benches. In order to reduce the workers' involvement in management, and thus safeguard production, Chairman Mao introduced in 1962 the "independent operational authority", which Professor Schurmann has defined as a divisional organisation, similar to those found in large commercial organisations.[39] This was supposed to limit the number of workers involved in management decisions.

The 1966 cultural revolution re-introduced the workers into management. The management of enterprises was to be supervised jointly by the masses of workers and staff members. Once again the individual, independent decision-making managers were disposed of.

When Chairman Mao had to curtail the powers of the Red Brigade - the torchbearers of the Cultural Revolution - he had to call in the army in order to guarantee continuity of production. This fact illustrates the workers' reluctance to relinquish their managerial functions.

The Communist view of management is described by Professor Hazard as:

> "a sociall y conscious collective of workmen, sharing decisions of a productive nature, including the dismissal of workers, and policing itself, through social persuasion rather than through the courts."[40]

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39 Schurmann, supra., note 37, p.122.

40 Hazard, p.198, supra, note 10, p.111.

The Gang of Four re-introduced collective management, which was partially blamed for the decreased production of 1975-76. At the beginning of 1979 the Government, headed by Hua Guofeng, was still dealing carefully with the subject of "collective management". This is concluded from an article which appeared in the **People's Daily**, and was quoted by **Xinhua News Agency** on March 9, 1979[40], and which called for increased production.

> "Listen to the workers' views and work out explicit targets with them. There must be democratic management in enterprises... The workers' democratic rights of taking part in the management of the enterprises must be safeguarded..."

The concern expressed by the writer of the article for the continuity of workers' participation in management must have been precipitated by the re-introduction of professional managers in accordance with the new policies. Later on, the article points out that the movement to increase production should be combined with technical innovation and technical revolution. This addition illustrates the schizophrenic attitude of the People's Republic of China towards "individual management". On the one hand it is realised and admitted that modern industry needs technical know-how, which can best be provided by professionally qualified managers. On the other, it is feared that the introduction of professionals will minimise the workers' participation in management, and undermine the principles of socialist democracy.

Despite the fear that independent management might decrease the workers' power of decision-making in their own workplace, it is being re-introduced into China's industry, not in the form of the "one-man management" system copied from the Russians in the 1950s, but in a more rational and professionally justified manner. In June 1979 the National People's Congress (NPC) discussed the readjustment of China's economy,

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41 "'People's Daily' calls for Production Economy Campaign", Xinhua News Agency, news item 03097, Mar. 9, 1979, p.8.

and among other things recommended improvement of the management of enterprises by introducing the participation of technical experts. The Congress also recommended the introduction of "responsible management", which means responsibility of factory directors, under the leadership of Party committees.[42] Although the present meaning of "responsible management" includes more independent decision-making on the management's part than before - for example in purchasing, marketing and product design - it cannot yet be identified or compared with the American meaning of a "boss", who takes risks on financial and managerial issues, and is accountable to no one. Still it is a step towards correlating industrial management with accountability of decision-making.

The gap between professional management and individual management is not that big, because professional management invariably leads towards a more personal management style which relies on the manager's skill and expertise. In 1979 the **Beijing Daily** reported the efforts of the Beijing municipality to increase production by the application of expertise, and by the discovery of outstanding individuals, especially young and middle-aged managerial personnel who were efficient and skilled in their work.[43] The former egalitarianism in the evaluation of the workforce seems to be giving way to the appraisal of the individual.

Concerted efforts are being made by the Government to increase the professional managerial ranks. In a national conference on commercial education, which was sponsored by the Ministry of Commerce, it was decided to run five different types of commercial-education institutions. These included secondary schools specialising in accountancy, pricing,

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42 "NPC Deputies Discuss Readjustment of China's Economy", Xinhua News Agency, news item 062369, June 24, 1979, p.3.

43 "Beijing Leading Officials Help in Drive to Increase Industrial Production", Xinhua News Agency, news item 071106, July 11, 1979, p.13.

statistics and business management.[44]

In their drive for increased production, the Chinese leaders of the Communist Party are ready to forsake old ideologies. The new ones are referred to as "the correct ideological line and flexibility in economic work",[45] inferring that the former ideology was wrong and inflexible. The new ideologies have to be adopted in order to increase production: "To breathe life into production it was necessary to liberate the mind and activate the thinking and reform the management system that fettered the production forces."[46] It was also recommended that incentives for increased production should be given. These were to be in the form of more independence for the production brigades in the State-owned enterprises, i.e. planning at local level, rather than centrally; and strict implementation of the principle of "to each according to his work." This increased independence was also intended for private individual enterprise.[47]

The trend towards increased professionalism in the management of enterprises has also been directed towards agricultural enterprises: the intention is to dispatch trained managerial and marketing personnel to rural areas, to lend their skills to the local enterprises.[48] The official seal of approval for professional management was given by the Chinese rulers with the foundation of a business management association in Beijing, the first of its kind in the capital. The association will be affiliated to the China Industrial Management Association, which was set up in

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44 "More Businessmen and Catering Experts Trained", Xinhua News Agency, news item 072110, July 21, 1979, p.18.

45 "Guangdong Provincial Party Secretary Stresses Correct Ideological Line and Flexibility in Economic Work", Xinhua News Agency, news item 081604, Aug. 16, 1979, p.3.

46 Ibid.

47 Ibid.

48 "China to Train More Commercial Workers for Rural Areas", Xinhua News Agency, news item 083013, Aug. 30, 1979, p.14.

March 1979.[49]

"Independent management" as required by the USA small business definition, in the sense of total responsibility of the manager for his industrial decision-making, is found in the People's Republic of China only in the individually owned businesses: the one-man family enterprises of tradesmen and very small manufacturers. Owing to the prohibition on employment of others, only family members are allowed to be employed in a privately owned enterprise. The management of the other form of private ownership - the co-operatives - could also be considered as "independent management", because the concept of a co-operative is basically an extension of the owner/manager unit. But whereas in the latter the ownership and management, and consequently the responsibility and risk, are borne by one or a few, in the former they are shared between its members, each being a part owner/manager. It can therefore be said that the management of a co-operative is independent, in the same connotation given to it by the USA definition of small business.

(iii) Small Market Share in the People's Republic of China

The third element in the USA **Small Business Act** definition of a small business is that it should not be dominant in its field of operation. This stipulation can be understood in two ways. The narrow interpretation, that it should not be a large, influential producer of any one commodity, finds great support in the People's Republic of China, where the diminutive unit size in the private sector (imposed by Articles 5 and 7 of the 1978 Constitution), could have only an extremely small share of the market. A wider interpretation of a "small market share" implies the existence of

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49 "Beijing Sets Up Business Management Association", Xinhua News Agency, news item 091229, Sept. 13, 1979, p.9.

competitors. Competition is the essence of American economic philosophy and, to a lesser extent, it is also the basis of all the free market economies. Small businesses, with a small market share, ensure the continued existence of competition.

In socialist thinking, competition is synonymous with the exploitation of the workers, as it is considered responsible for price cuts which lead to reduced wages. The socialist hostility to competition is manifested not only by the socialist economies, but also by socialist ideologists living in capitalist economies. Nicholas Falk, in **Think Small, Enterprise and the Economy**,[50] mentioned that one of the objections of some socialists to small firms is that they represent competition, which is seen as both wasteful and in conflict with socialist principles. He concedes that although competition might involve a certain amount of wastage, it is a good way of keeping large companies on their toes. He also mentioned the Polish example, where small businesses were actively encouraged because of the recognition that the varied and special needs of human beings are ill-served by an economy boasting of having only large companies.

With the new developments in China, the classic communist attitude towards competition is also being re-assessed. Recognition of some of its economic benefits, was expressed in an article by Mr Wu Tongguang of the Beijing Institute of Finance and Trade,[51] who defined socialist competition as a conscious application of the "law of value", based on socialist public ownership, and guided by the basic law of socialism. He argued against the old way of thinking that equated competition with capitalism and he held it

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50 Nicholas Falk, Think Small, Enterprise and the Economy, Fabian Tract 453, Jan. 1978, p.20.

51 Wu Tongguang, "Competition Can Be of Use in Developing China's Socialist Economy", Guangming Daily, partially reproduced in English under the heading "Socialist Economy and Competition" by Xinhua News Agency, news item 032403, Mar. 24, 1979, p.13.

to be inimical to a socialist economy. To improve production and increase sales, commodity producers had to compete. Negation of competition would bar the recognition and use of the "law of value", and make it difficult to achieve the best possible economic results. He advocated competition among producers and traders, "let the factories and shops feel the pressure... "

> "... If a product is poor in quality, sells at too high a price, or does not meet the demands of the market, trade departments can reject it and buy from other manufacturers. Such competition is sure to put enterprises which are under constantly bad management and making big deficits in an unfavourable position. Some might have to change leadership, some have to close down. This might eventually prove to be of greater benefit to the development of our socialist economy. With strong leadership from the Party and the Government, plus correct policies and decrees, competition would not disrupt the planned economy or lead to capitalism."[52]

Wu Tongguang's article is of major importance in understanding the conflicting, even schizophrenic attitudes currently experienced in the People's Republic of China. On the one hand the ideals of Communism are pulling against competition, and on the other the practicality of a sound economy, is pulling towards it.

The benefits the Chinese hope to gain from competition are not dissimilar to those advocated by the Americans, namely better and more varied products at lower prices, for the people's benefit. In the USA, the reference would be to the "consumer" rather than the "people". In economic terms "consumer and "people" would amount to the same, i.e. the final users of the product. The USA consumer of today is in a very powerful position owing to the prevalence of competition, backed by favourable legislation; whereas the people of China, in their role of end product users, are in a much weaker position.

The Chinese have managed to justify private ownership as compatible with socialist principles; they have also managed to excuse independent management, to a certain extent, but they have found the advocacy of competition a hard task. When the Chairman of the Revolutionary

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52 Ibid.

Committee in Zhejiang Province, MrTie Ying, called for a measure of competition among the shops, including State-and collectively owned ones, in order to break the monopoly of State-owned commercial enterprises[53], he justified socialist competition as being unlike that of capitalism, which is a cut-throat competition between one capitalist and another. He claimed that socialist competition was more benign and educational, and enabled enterprises to learn from each other in order to expand production.

A similar explanation of socialist competition has been offered by the Chinese army theoreticians. According to the **Liberatiom Army Daily**, as reprinted in the **People's Daily** of May 19, 1979, there are three differences between capitalist competition and socialist "emulation".[54]

The first is the aim of capitalist competition to maximise profits by exploiting the worker's surplus labour. This is in direct contrast to the absence of workers' exploitation in the socialist enterprises, with public ownership of the means of production. The second difference is the anarchy in production and the efforts to cut others' throats in capitalist competition, whereas socialist emulation, under the guidance of State planning, was conducted in a spirit of comradeship. The third difference concerned the monopoly created by capitalist competition, whereby some enterprises controlled or took over others, causing the losers to go bankrupt and dismiss workers. This could not be brought about by socialist emulation, whose task was the improvement of management and the raising of labour productivity.[55]

Despite the short duration of its existence in the People's Republic of China, the benefits of competition have already been felt. In a fair at

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53 Supra, note 34, p.120.

54 "Cadres Study Economic Questions", Liberation Army Daily, reproduced in English by Xinhua News Agency, news item 051915, May 19, 1979, p.20.

55 Ibid.

Zhaoxian County, Hebei Province, the variety of agricultural products has increased from 94 to 170, and with it the volume of business[56]. The availability of consumer goods in Shanghai increased by 30% in the last year owing to the co-operation between State- and collectively owned handicraft industries[57]. Competition has also improved the performance of State employees in the service industries, whose monopolistic habits have been shaken up by the introduction of private enterprise[58].

It is not expected that the competition proposed for the economy of the People's Republic of China will be as fierce and ruthless as the one prevailing in the USA. But it is equally not expected that competition in China will remain as mild as is aspired to by the Chinese economic theorists. They see the development of competition on lines similar to those practiced by the capitalist giant corporations, which encourage competition among their own subsidiaries with the intention of increasing motivation and production.

The main differences between competition in the USA and in the People's Republic of China is that in the USA it has been practised since the inception of the nation, and has therefore a proven track record. And although there is no unanimous agreement as to the merit of all its features, they are at least identified, while in China it is an innovation, the direction and consequences of which are not yet known and therefore can only be speculated upon.

(iv) Small Businesses in the People's Republic of China

Until mid-1979, it would have been correct to state that the three essential elements of the USA small business definition would have been

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56 Supra, note 16, p.115.

57 "More Consumer Goods in Shanghai", Xinhua News Agency, news item 060811, June 8, 1979, p.14.

58 Supra, note 28, p.118.

rejected by Chinese thinking. This would have meant that the existence of small businesses according to the USA format would not have been possible there. Yet the Chinese have been claiming all along that they had small businesses.

A 1975 official Government Publication described the rapid growth of small and medium industrial enterprises and their important role in the national economy. It disclosed the facts that small nitrogenous fertiliser plants accounted for 54% of the total production of that item, that small cement works accounted for more than half the national production, and that small hydro-electric power stations provided electricity for many remote regions[59].

In compliance with the following economic directions given by Chairman Mao in the spring of 1957: "...but the majority of our enterprises should not be built on such a scale; we should set up more small and medium enterprises...", the Chinese have adopted the "walking on two legs" policy, which meant a mixed economy in which large industry was supplemented by small enterprises. The Chinese justified this policy by explaining that the construction of large-scale modern enterprises could only be undertaken by the State, since large investment, concentrated resources, modern communication facilities and complex technology and equipment were required. In comparison, small enterprises required much less investment, simpler equipment, and took a shorter time to build up. They could be set up by the provincial administrations and municipalities, people's communes and neighbourhood committees. It seems that China did not differ from the capitalist economies when it came to acknowledging the advantages of the small business; where they did however differ was in the identity of their owners. In the USA the ownership of most small

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59 "Why China Builds Small Industrial Enterprises", New China's First Quarter Century, Foreign Language Press, Peking, 1975, p.24.

60 Ibid., p.26.

businesses was private, while in the People's Republic of China it was mostly in public hands until mid-1979.

The period 1958-60, being the years of the Great Leap Forward, saw the establishment of thousands of small industries in China.[61] In 1976, Professor Joan Robinson expressed the opinion that the development of small industries in the communes was going to continue.[62] And in 1979 in Xianghan, an industrial city in Hunan province, the existence of 400 small plants and mines was recorded.[63] The evidence so far presented, which has shown that small businesses have always existed in the People's Republic of China, referred to small business under public ownership. However, there is also proof of the existence of privately owned enterprises there. In 1965, an article by Hsiao[64] mentioned the existence of private ownership. According to him, there were about 10 million tailors, carpenters, blacksmiths and the like in the countryside, and about 3-5 million in urban areas, most of whom were organised into co-operatives. These numbers were later considerably reduced during the rule of Lin Biao and the Gang of Four.

In the agricultural sector,[65] the population was once again[66] allowed to use "self restrained" land, which meant small plots for raising domestic

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61 Carl Riskin, "Small Industry and the Chinese Model of Development", China Quarterly, No.46, Apr.-June 1971, p.245-273.

62 Professor Joan Robinson, Economic Management in China, Anglo-Chinese Educational Institute, Nov. 1976, p.39.

63 "Co-ordination Between Factories Spurs Urban Industry", Xinhua News Agency, news item 031307, Mar. 13, 1979, p.11.

64 Gene T. Hsiao, "The Role of Economic Contracts in Communist China", Cal.LR, Vol.53, 1965, p.1039.

65 Ibid.

66 The right to own small plots of land for the growing of food products for private consumption had been withdrawn by the CPC resolution of Feb. 16, 1959. The restoration of this right to peasants was granted in Oct. 1961.

animals and growing vegetables. These plots comprised about 5% of China's cultivated land. In the industrial sector, the regime limited private ownership to the handicraft industry only. The policy was to allow the co-existence of State, collective, and individual ownership, with State ownership as the principal form. Although the production scale of each self-employed person is negligible, even if viewed by the size standards of small business, the sheer numerical production capacity of some 15 million self-employed is enormous. The fact that in 1965 15 million individuals were outside the planned economy system is significant, even in relation to China's total population. But the arrival of the "Cultural Revolution" changed all that.

The resurrection of the private sector of small businesses started towards the end of 1978. The first official report, admitting the revival of private commercial activities, appeared on March 12, 1979.[67] It reported the existence of some 30,000 country fairs, which sold agricultural produce grown by the peasants on their private plots and handicraft items. Although the prices were reasonable, the reporter was concerned that such a burst of private commercial activities could affect the "socialist planned market." He expected the Government to watch this trend, and to exercise the necessary controls to protect legal trade and curb speculative activities. This first official report of the existence of small private enterprise was followed by further confirmations, substantiations and details. On March 28, 1979, increased transactions at the peasant markets were reported,[68] but it was stressed that these private activities of the peasants had not interfered with their production obligations to the State. On the contrary, it was noted that their production to fulfil the

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67 "Brisk Trade at Rural Fairs in China", Xinhua News Agency, news item 031206, Mar. 12, 1979, p.8.

68 "'People's Daily' Editorial on Peasant Markets", Xinhua News Agency, news item 032808, Mar. 28, 1979, p.10.

State quotas had actually increased, as did their own private production:

> "...facts have proved that peasant markets are indispensable to the economic life of the people...It is necessary to encourage the peasantry to develop domestic sidelines to increase their income and invigorate the rural economy as a whole."

The article ends by assuring the readers that peasant markets are not capitalist enterprises and that they are under Government control, which forbids illegal transactions and speculations. The two contrasting aspects of the situation cannot be ignored: the success of the private sector with its ensuing benefits to all concerned, State and individuals alike; and the fear that it might develop into large-scale enterprise and resemble capitalism.

On July 13, 1979, the **Beijing Review**[70] echoed the official change of policy regarding the private ownership of small businesses, which had freed them from their capitalistic stigma: "Both ownership systems (the State and the collective) are socialist in nature, each having its advantages...", and praised their efficiency and quick return on capital. In addition, it was suggested that workers in these enterprises should get higher wages and more fringe benefits if they produced more than the workers in the State enterprises.[71] A similar view was expressed in an article in the **Guangming Ribao**[72] of Beijing, which commented: "Collective ownership, and ownership by the whole people, should be allowed to support, learn and emulate each other and exist side by side for a long time to come."

Since March 1979, the Xinhua News Agency has repeatedly reported

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69 Ibid.

70 Supra, note 7, p.109.

71 Ibid.

72 Quoted by the Beijing Review, supra, note 7, p.109.

on the increase of individually and collectively owned private enterprises, about their value for the economy, and about their role in the absorption of unemployment.

That small businesses do exist in the People's Republic of China is a fact. That they possess characteristics similar to those displayed by small businesses all over the world - versatility, adaptability, low capital expenditure, low expenses, and simple technology - is also a fact. And that they are reconcilable with most elements of the USA definition of small business is a fact as well.

It seems that the objection to private ownership stems from the concern about its uncontrollable growth, and the fear that it might overtake public ownership and threaten its existence, rather than from hostility to the principle of private ownership in itself. Therefore the existence of small businesses ought to be welcomed, because it would provide the advantages of the existence of private ownership without the disadvantages caused by the size of large firms.

(v) The Small Business Definition of the People's Republic of China

Had not a small business definition been proffered by the **Beijing Review**,[73] it would have had to be constructed on the basis of the prevailing attitudes of the People's Republic of China towards the three criteria of the USA definition: independent ownership, independent operation, and "non-dominance in its field of operation". Such a Chinese definition would have read as follows:

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73 Supra, note 7, p.109.

A small enterprise is one which is owned individually, or by a collective of working people,[74] who participate in the democratic management of their own workplace.[75] In the rural areas, its production has to give priority to the fulfilment of Government quotas, and in the urban areas it has to adhere to Government price controls and raw material allocations.[76]

As the suggested definition has been modelled on the USA one, it relies fundamentally on economic criteria, whereas the definition published in the **Beijing Review**[77] is a synthesis of economic, ideological, political and legal criteria, as will be elucidated subsequently.

The first paragraph of the latter definition relates to the limited size of the enterprise, but does not specify its numerical upper limits. It correlates the small size with low capital investment, "Built with little investment, they have gone into production at a relatively fast speed and have yielded quick results." The emphasis on productivity ought to be seen in the light of the present great concern with the elevation of the people's

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74 Individual ownership or ownership by a collective of working people is permissible and recognised according to the 1978 People's Republic of China Constitution, as long as the owners fulfil the working function as well (Article 5 of the Constitution). The stipulation that the owners should work actively in the enterprise is demanded also by the Italian definition of the Artisanat, Law No.860 of July 25, 1956.

75 The independent operation of the USA definition is paralleled by the Chinese definition of a collective as having ownership by the working people. Here, as in the USA, the management right is derived from the ownership.

76 The "small market share" element, relied on by the USA definition, is achieved in the People's Republic of China by Government controls which are imposed on all non-State enterprises. In the rural areas these take the form of restricting expansion by forcing the farmers to fulfil the State's set production quotas, before attending to the collective's or the individual's needs. In the urban areas, the Government price controls, coupled with the centralised allocation of raw materials, guarantee that the profitability and expansion of small enterprises is kept in check.

77 Supra, note 7, p.109.

standard of living, and the freer availability of consumer goods.[78]

This part of the definition is based on economic criteria.

The second paragraph deals with independent ownership and independent management: "Based on independent accounting, they are responsible for their own profits and losses." This part of the definition uses legal criteria. The "independent accounting system" and the "responsibility for their own profits and losses" conditions create a set of legal obligations, only applicable to those who do not manage their own enterprises. The "independent accounting system" and "responsibility to their own profits and losses" mean that the owners/managers of the small enterprises have a legal obligation to pay taxes according to the profits attained. This is not the case with workers in the State-owned enterprises, whose responsibility is separated from that of the enterprise.

The last part of the second section uses an ideological, political criterion, which though relying on "what is", recommends "what should be". Its propagandism is undisguisable: "Since poor or good management directly affects their own interests, the people working there have rid themselves of the 'iron rice-bowl'[79] mentality, which is harmful to raising efficiency." It is not suggested that the above description is not characteristic of small owner/manager enterprises; yet , because it is expressed in a subjective manner, it ceases to be a mere description of "what is" and enters the realm of "what should be".

The third part of the definition resorts again to an economic

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78 "Pay attention to consumption", People's Daily, Beijing, Oct. 20, 1979. The article deals with the need to produce in order to "meet the ever-increasing material and cultural needs of the working people and society as a whole...When the production of consumer goods lags far behind that of producer goods, it is necessary to change the situation as rapidly as possible and pay more attention to the needs of the consumer..."Quoted by Xinhua News Agency, news item 102017, Oct. 20, 1979, p.19.

79 Supra, note 8, p.110.

criterion - that of flexibility in fulfilling market demands: "They have the advantage of being flexible in production, and readjustments can be easily made to meet the market needs." This part of the definition echoes once again the leadership's desire to develop light industries, for the dual purpose of exporting and of supplying the local consumer needs.

In the context of the People's Republic of China's history and attitudes towards the constrictions of laws and definitions, it is significant that at the same period, July 1979, when the first seven laws in 30 years were promulgated, a qualitative definition of small businesses was also introduced into the foreign-language publication of Beijing. The mere publication of such a definition, though not through a legal channel, was a step towards the liberalisation and regularisation of private ownership and management in the People's Republic of China.

Conclusion

From the sporadic news items and publications which arrive from the People's Republic of China, it is possible to deduce the present significance and status of small business there. There is no doubt that small businesses,in the form of private and collective ownerships, do exist there, despite the strict communist dictum that the ownership of the means of production ought to be held by all the people and not only by part of them.

There exists, however, a distinction between the two types of non-State ownerships - the collective and the individual - in that the latter are restricted in their growth potential by the prohibition on the employment of others (except close family members), which invariably limits the size of the business and prevents its growth; while the collectively owned enterprises escape the employment restriction because

their labour force is composed of their members, who are not salaried employees. As the prohibition is only on the employment of outsiders, the collectively owned enterprises which employ their own members escape this ban and manage to expand. If the supply of raw materials had not been State-controlled, there would have been no ceiling on their growth, which would have meant an expanding sector of privately owned industries. It seems therefore that the curtailment of the private sector is due not so much to the communist prohibition of "employment", which the Chinese seemed to have overcome, but to the State's allocation of raw materials, without which no growth is possible.

The Communist regime of the People's Republic of China has accepted the co-existence of a limited degree of private ownership and State ownership; and this acceptance continues today. The only break in this continued toleration took place during the Cultural Revolution and the rule of Lin Biao and the Gang of Four, who were totally opposed to any measure of private enterprise. Now not only has co-existence been re-instated, but there are even signs that the private sector is growing.

CHAPTER SEVEN

QUALITATIVE DEFINITIONS OF SMALL BUSINESS IN THE UK, THE FEDERAL REPUBLIC OF GERMANY AND ISRAEL

Introduction

The comparison between the qualitative definitions of the USA and the People's Republic of China was undertaken with the purpose of finding out whether such different economic philosophies and practices could host the same defined. But the present comparison, between the qualitative definitions of three countries which belong to the same economic system, starts with the assumption that, owing to the similarity of their economic ideologies, their definitions of the same defineds ought to be, if not identical, then at least similar. Were it found not to be so, then one would endeavour to establish the reasons for that.

The Federal Republic of Germany is not one of the countries being compared in this study, but on account of the scarcity of qualitative definitions of small business, it was decided to incorporate it in this chapter in order to widen the scope of the comparison.

(i) The UK Qualitative Definition

The UK is the only European country with a semi-official qualitative definition of a small business. It is considered as only semi-official, because it is not a legal, a juristic, or an administrative definition, and though frequently referred to, it has not been officially endorsed. The definition was originated by a Royal Commission appointed by the President of the Board of Trade on July 23, 1969.[1] The mandate given to the Commission was to consider the role of small firms in the context of the

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1 The Rt. Hon. Anthony Crosland.

national economy. Some two years later, on September 21, 1971, the Committee, under the chairmanship of J.E. Bolton, submitted its report, which included a definition of a small business.

The following was the definition which was adopted by the Committee to describe small businesses:[2]

> "Firstly, in economic terms, a small firm is one that has a relatively small share of the market. Secondly, an essential characteristic of a small firm is that it is managed by its owners or part owners in a personalised way, and not through the medium of a formalised management structure. Thirdly, it is also independent in the sense that it does not form part of a larger enterprise so that the owner-managers should be free from outside control in taking their principal decisions."

The definition contains the following elements in the prescribed order:

1. Small market share.
2. Private ownership.
3. Owner/part owner-management.
4. Personalised, not structured, management style.
5. Not a subsidiary.

Small market share. The element of small market share has been used also by the USA **Small Business Act** and the **Selective Service Act**, which defined small business, though their wording was different. The "market share" was referred to as "not dominant in its field of operation", and was correlated to "competition". The role of the UK small business in the promotion of competition has been studied by the Bolton Committee, which supported the economic philosophy that in a free-enterprise economy, the customer's protection against exploitation, and the responsiveness of the system to consumers' needs, including the suppliers' incentive to greater efficiency, relied on the maintenance of effective competition between firms.[3] Except for the value of the "small market

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2 J.E. Bolton, Small Firms: Report of the Committee of Inquiry on Small Firms, HMSO, London, Cmnd.4811, Nov. 1971, p.1.

3 Ibid., p.33, table 3.1.

share" in the maintenance of competition, it was observed that on the whole "small firms" do actually control only small shares of their specific markets.[4] The positioning of the "small market share" as the foremost requirement of the definition is similar to that of the USA **Selective Service Act**, whilst in the **Small Business Act** definition, this condition appears last.

Private ownership is not a direct, but an implied, condition of the definition. The stipulations "managed by its owner", and "does not form part of a larger enterprise so that the owners are free from outside control in taking their principal decisions", imply private ownership, because owners who are "free from outside control" are invariably private owners. Thus, although the actual words of private, individual or independent ownership are not included in the definition, the element of private ownership serves as its basis.

Management - by owner, as required in the UK definition, is another way of describing the "independent management" of the USA definition, or the "responsible for their own profit and losses" of the People's Republic of China.

The requirements of the UK definition exceed those of the others, which stipulate only that the management should be undertaken by the owner, but the UK definition is not satisfied with this condition; it demands that the owner should manage in a specific style, he should manage in an unstructured, personalised manner. The Bolton Committee's image of a small business as one which is managed only in a personalised manner must have been influenced by a study commissioned by them from C.W. Golby and G. Johns,[5] who found that on the whole, the English

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4 Ibid., p.33, table 3.1. The relative importance of small firms in different industries was estimated from reports on the Censuses of Production and Distribution, 1963, and other official inquiries.

5 Ibid., p.23, 2.44-2.45.

owner/manager was not a glamorous figure. Among other faults, he was found to have a lower standard of education than his counterpart, the professional manager.[6]

The personalised, non-structured management style requirement does not co-exist comfortably with the quantitative part of the definition, which considers a manufacturing unit with an upper limit of 200 employees as a small business. It is an accepted fact that to manage successfully a 200-employee production unit in a western free-economy country, one needs a structured style of management. It is difficult to accept that the Bolton Committee was unaware of this.

The personalised style of management could have been an accepted qualification, had the maximum number of employees been lowered. In Israel, which subscribes to an upper limit of 50 employees, this numerical choice was explained as the point where changes in productivity take place.[7] The fact that productivity changes at the 50-employee mark, can be due to the effects of management style, which up to that size is usually of a personalised character. The differences between the relationship of "personalised"[8] and "structured"[9] management with employees are appreciated, as are the different reactions of employees to different management styles.[10] It is also known that in certain industries and production lines, better results are achieved under specific management

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6 Ibid., p.24, 2.48

7 Dr. S. Dombrovski, "The Potential of the Israeli Small Industry in a Macro-Economic Context". A report (in Hebrew) submitted to the Israeli Institute of Productivity, June 1976, p.18.

8 Bolton, p.21, 2.40, supra, note 2, p.142.

9 Ibid., p.112, 10.3.

10 S. Talacchi, "Organisation Size, Individual Attitudes and Behaviour: An Empirical Study", Administrative Science Quarterly, Dec. 1960.

techniques.[11] The Committee must have believed that personalised management was such an essential component of small business, that without it, an enterprise could not be considered a small business. The Report referred to Hollander[12] and Kaplan[13], sociological researchers, who suggested that the personalised management syndrome was a characteristic of small business. It should, however, be mentioned that their researches were carried out on a relatively small sample, and concentrated on specific industries, where this characteristic could have been more emphasised.

The final stipulation of the Bolton definition is that it should not form a "part of a larger enterprise", which means that for an enterprise to be considered a small business, it must not be a subsidiary or an affiliation of another enterprise. This condition is, in effect, a repetition and explanation of the "independent ownership" element, which was already implied in the "independent management" stipulation. When the USA **Small Business Act** considered it necessary to explain the meaning of "independent ownership",[14] it did so in the regulations, instead of encumbering the main definition.

(ii) The Federal Republic of Germany's Qualitative Definition

The German definition, like the English one, is neither a juristic nor a legal definition, as it was not incorporated into any law. The definition appeared in a governmental guideline for a structured policy for small and

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11 C.F. Pratten, "Economies of Scale for Machine Tool Production", Journal of Industrial Economics, Apr. 1971, p.165.

12 E.D. Hollander and others, The Future of Small Business, Praeger, New York, 1967, p.4-5.

13 A.D.H. Kaplan, Small Business: Its Place and Problems, McGraw Hill, New York, 1948, p.17.

14 Rev.13 39 FR 44424, Dec. 24, 1974, 13 CFR 121 3-2.

medium-sized enterprises.[15] The fact that this definition was not mentioned in a French study of private enterprises in the EEC, which was published in March 1978,[16] indicates the lack of authority of any definition which is not incorporated into a legislative Act.

The German definition introduces new elements, which were not encountered in the definitions hitherto studied. The definition reads:

> "By ... small & medium enterprises are meant enterprises which do not as a rule borrow on the capital market, and which are run independently by persons working on their own account, who are themselves directly involved in the work of the firm and bear all the risks."

The three main elements of the definition are:

1. Restricted access to the "money markets".
2. Management by an independent working manager.
3. Total risk borne by self-employed, working manager.

The inhibited use of the "money markets" is one of the new conditions imposed on the small business by the German definition, and although characteristic of many small businesses, could apply also to a large enterprise which chose not to become public.

If the meaning of "control" had been interpreted as in the USA regulations, whereby a control of 50%[17] of the voting shares was sufficient, it would have meant that "a company" would include also a "public company" whose shares were quoted on the stock market. This would have meant an automatic access to money markets, despite the fact that the owner/manager owned and controlled only 50% of the voting shares, which

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15 "Grundsätze einer Strukturpolitik für kleine und mittlere Unternehmen", (Bundestag-Drucksache VI/1666), (Guidelines for a structural policy for small and medium sized enterprises).

16 A. Sayag and C. Jauffret-Spinosi, L'Entreprise Personnelle. 1.Expériences Européennes. Etudes du Centre de Recherche sur le Droit des Affaires de la Chambre de commerce, et d'industrie de Paris, Librairies Techniques, Paris, March 1978.

17 Rev.13 39 FR 4424 Dec. 24, 1974, 13 CFR 121 3-2(a), (iii) (a).

entitled him to the status of a small business.

The stipulation of the working manager, who works on his own account and runs the business independently, is another of the definition's innovative conditions. The American definition requested "independent management", the English added "personalised style of management", and the German the "working manager". This requirement of a "working manager" resembles the Chinese and the Italian[18] definitions, which intended the small business to be what it was expected to be - small. This is in contrast to the American definition, which did not deal with an absolute size, but with a relative one, comparable to other enterprises in the same sector; and to the English one, which accepted an enterprise with 200 employees as small.

The third condition of the definition, which stipulates that the total risk ought to be borne by the working owner/manager, seems unnecessary, as it is usual for the private owner of a small business to bear the risks. But if the definition intended to exclude working owner/managers who were wholly or partially financed by others, but who had a majority holding and control, without the financial risk usually associated with it, then the "personal risk-taking" element is essential. This means that as long as the working owner/manager bears all the risks, the business is "small", despite the fact that it might have a large number of employees or a high turnover. The same risk taking element appears also in the Chinese definition, "working owners who are responsible for their own loss or profit".[19]

Another explanation for the German definition's emphasis on the seemingly obvious element of risk-taking by the private owner could be its wish to portray the small businessman as an entrepreneur, and not as a

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18 Italian definition of the Artisanat, Law No.860 of July 25, 1956.

19 "Collective Ownership, Bright Prospects", Beijing Review, No.28, July 13, 1979, p.4.

mere "bourgeois capitalist". This could account for the accentuation of the social qualities of the small business proprietor, like "working on his own account", "directly involved in the work", and a "risk bearer". The presentation of the socially conscious individual is an appropriate image to be created by a capitalist country like the Federal Republic of Germany, which has realised that the changing social economic climate cannot accommodate, nor remunerate, the old style of conservative capitalism, in which the owner is always the owner and the worker is always the worker.

In comparing the elements of the Federal Republic of Germany's definition with those of the People's Republic of China, it can be seen that the gap between the two poles of the economic system is narrowed, when the subject is that of small business.

(iii) The Israeli Qualitative Definition

Israel, in common with most countries, does not have an official qualitative definition of small business; nor does it have a legal or juristic one. The Israeli Small Industry Advisory Centre, which is the official organ dealing with the managerial and financial problems of small businesses and sponsoring research in related subjects, has its own qualitative definition. To what degree this definition is accepted and used is impossible to assess owing to lack of data. The definition is based on the managerial function of the small business manager:

> "A small enterprise is one whose manager carries out most or all the managerial functions."[20]

M. Peled, who is responsible for this definition, adds that in specifically defined cases, it is possible to add to the definition other criteria, such as number of employees, turnover, investment or capital expenditure - each in accordance with the aims of the definition. This definition

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20 M. Peled, Director of the Israeli Small Business Advisory Centre, The Small Industry in Israel, Faust & Sons Ltd., Haifa, 1976 (in Hebrew), p.5.

dispenses with the independent ownership and independent operation of the USA definition, as it does with the independent, personalised management of the English one. The rationale of this definition is based on the assumption that only an "owner/manager" would be able and willing to carry out all the managerial functions himself. Mr Peled ignores the cause of this situation - the independent ownership/management element - and deals directly with the result: the carrying out of all managerial functions by the managers.

Such a definition is not incorrect, as in the early stages of most businesses, the owner/manager does indeed carry out all, or most of, the managerial functions. But the duration of this period in a business's development depends on the manager's individual capabilities, skills and personality. Mr Peled's definition, more than any of the other definitions, curtails the size of the small business to an absolute minimum. The personalised management of the English definition requires only a paternalistic approach by the management, but does not stipulate that the manager has to be a shop-floor manager; thus allowing him the time to expand the business to the respectable size of 200 employees. The German and Chinese definitions restrict the enterprise's size by demanding that the manager should be a working person. The Israeli definition reduces the size of the small business even further, by expecting the manager to carry out the managerial duties himself.

CHAPTER EIGHT

COMPARATIVE CONCLUSIONS

The comparison of the qualitative definitions of the USA, the People's Republic of China, the UK, the Federal Republic of Germany and Israel, has led to the following evaluations and conclusions:

1. That small businesses exist in all these countries.
2. That independent ownership is a requisite of all the definitions.
3. That the meaning of independent ownership varies from country to country as detailed:

In the USA - it comprises all legal forms of private ownerships, including that of a public quoted company, as long as some 50% are held by its originating owners or managers.

In the PRC - it means:

(a) non-State ownership,

(b) co-operative ownership,

(c) working owners.

In the UK - it comprises all legal forms of private ownership, including a public quoted company, as long as its management's decision-making is independent. This is based on the assumption that majority shareholders are independent in their decision-making.

In Germany - it means:

(a) a private concern, excluding a quoted public company,

(b) a working owner, who bears the total risk. A sleeping partner or financial backer would be excluded.

In Israel - the owner is assumed to be a private individual.

4. That independent management is a condition of all definitions.

5. That the meaning of independent management varies from country to country, as detailed:

In the USA - it is tantamount to control, which is inter-linked with ownership. The stipulation is not actually for independent management, but for independent operation. This means that the managerial duties do not have to be carried out physically by the owner, but only the operation of the enterprise, i.e. the control. There are no restrictions on the management style.

In the PRC - management has to be carried out by the owners, if the enterprise is privately owned, and by the members of the collective, if collectively owned. Independent management means independent accounting and risk taking. This is tantamount to the classical owner/manager management. There is no restriction on the managerial style.

In the UK - management has to be by the owner - or part owner. It has to be independent from any outside control. The style of management is specified as being "personalised". This means actual physical management, and excludes the USA type of operational control.

In Germany- management has to be undertaken by the private owner, whose style of management, though not dictated, is indirectly specified. The manager cannot be a full-time manager, as he is expected to fulfil work functions as well.

In Israel - the management is assumed to be carried out by the owner, and the style of management is prescribed. The manager has to perform all or most of the managerial functions in person.

6. The small "market share" is either a direct or an implied condition of all the definitions:

In the USA -it is a direct condition, referred to as "not dominant in the field of operation", whose aim is to prevent monopolies and encourage competition within the same area of business.

In the PRC -it is an implied condition, because of the low "entry barriers", which are described by the definition as "small and medium enterprises with little investment and quick results". Low "entry barriers" encourage the entry of new enterprises. This introduces competion and the reduction of each enterprise's share of the market.

In the UK -it is a direct condition and is referred to as small "market share". Though it is not specified that the "market share" is that of a specified sector, it is assumed to be so, on account of the influence of the USA definition.

In Germany- the small "market share" is implied by the restricted financial resources and the working manager. Lack of finance and part-time management must inevitably hamper the growth of a business.

In Israel - the small "market share" is an implied condition, deduced from the qualification that management functions have to be carried out by the owner, which invariably restricts the "market share" of the enterprise.

7. Although the countries subscribe to different cultures and economic systems, their definitions of small businesses are not as different as the economic systems they practise.

II. The Definition in the Social Sciences

CHAPTER NINE

SMALL BUSINESS QUALITATIVE DEFINITIONS BY ECONOMIC THEORISTS

Introduction

The previous chapters have dealt with quasi-legal,[1] juristic,[2] and semi-official definitions,[3] which used qualitative criteria to define small business. In the present chapter it is proposed to deal with the scientific definition of small business, in which the definer can be any one, as long as he describes the defined according to his subjective view of truth. Though the scientific definitions do not pretend to be imperative, they do aspire to influence the juristic and the administrative definers,[4] who often rely on previous scientific definitions for the formulation of their own. The importance of a scientific definition is, therefore, not so much in its direct impact on the defined,but on its indirect one, through the mediating channels of the administrative and juristic definers.

Small businesses and their owner/managers have not featured widely in the economic writings of either the socialist or the capitalist camps. Their heterogeneousness, unpredictability and non-conformity with economic models has discouraged most capitalist economists from paying attention to

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1 Quasi-legal - the US Small Business Act 1953 definition.

2 Juristic - the US Selective Service Act 1948 definition.

3 Semi-official - the People's Republic of China, the UK, and the Israeli definition.

4 The small business definition of the Bolton Report was influenced by the definition of the social scientists Hollander and Kaplan; see p.141.

them. However, some, like Schumpeter,[5] Drucker,[6] Heinz,[7] and Knight,[8] were sufficiently intrigued by their existence to include them in their studies. Though they are not referred to in name as "small businesses", they can be identified behind terminology such as the entrepreneur, the founder, the risk-taker, the private owner, the family enterprise or simply the capitalist. In socialist writings, they are mentioned as small co-operatives,[9] small communes, small "kibbutzim",[10] small factories, private plots or simply the bourgeoisie.

(i) The Relationship Between Ownership and Management

That private ownership is an integral part of the small business concept is common to all capitalist economic thought. By capitalist private ownership is meant the specific identification of the whole or part of the property or its financial worth with a certain person or persons. Socialist economic thinking, however, managed to divorce the two without dispensing with small businesses as such. The idea of the socialist

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5 Joseph A. Schumpeter, "Economic Theory and Entrepreneurial History", Exploration in Enterprise, (ed.) Hugh Aitkins, Harvard University Press, 1965, p.65.

6 Peter F. Drucker, "Entrepreneurship in Business Enterprise", Journal of Business Policy, Vol.1, No.1, 1970.

7 Heinz Hartman, "Managers and Entrepreneurs; A Useful Distinction", Administrative Science Quarterly, Vol.3, No.3, 1959, pp.429-51.

8 Frank H. Knight, Risk, Uncertainty and Profit, University of Chicago Press, Chicago and London, 1971. Originally published 1921.

9 Mao Tsetung, "Co-operative Transformation of Agriculture", (July 31,1955), Selected Works of Mao Tsetung, Vol.V., Foreign Language Press, Beijing, 1977, p.187.

10 Uri Leviathan, "Industrialisation and Kibbutz Values, Contradictory or Complementary?", The Kibbutz, Interdisciplinary Research Review, published (in Hebrew) by Higher Education and Research Authority of the Federation of the Kibbutz Movement, 1975, Vol.2, p.11.

collective ownership is theoretically one of private ownership, since prima facie the members of the collective own their enterprise. But in reality, their ownership is restricted by the collective's rules, which in most cases restrict the transfer of shares only to specified persons, such as the owner's family, thus preventing the owner from realising their financial worth on a free market.

An owned enterprise has to be managed by someone, and the issues as to who has a right to manage it have engaged economists as diverse as Schumacher and Knight, in respect of the free-enterprise countries, and Marx and Lenin, in respect of the planned economies. In big business, ownership and management are mostly separated. In the capitalist economies, big business is owned by shareholders, and management is undertaken by professional managers.

In the socialist economies it is similar - big business is owned by the State (or, as referred to in the Constitution of the People's Republic of China, by all the people) and is managed by State employees. In small businesses, ownership and management are expected to be combined.

The right of an owner to manage his property has not been questioned, as ownership implies freedom of action over it. The management right enables also the transfer of this right to someone else. And as the forfeiture of the management rights does not relinquish the ownership, a small business should not cease being a small business when the owner relinquishes his right to manage the business and transfers it to a hired manager. But despite the straightforwardness of these arguments, the previously mentioned definitions all specify that a small business ought to be owner-managed. What is there, then, in the relationship between ownership and management, that makes it that essential for the small business to encompass both?

Usually a management right based on ownership is not restricted

to a specific style, whereas the management right acquired through the ownership of a small business is sometimes expected to be performed in a "personal" style. It can be reasoned from this that the combination of ownership and management creates new and different conditions which do not exist when the two are separated, and that there is a different type of management right in each case. If the "personal" style is not a direct by-product of the joint ownership-management, then it must be an indirect one, as it promotes differences between the personalities of managers with ownership rights and those who do not possess them.

The issue of the relation between ownership and management rights arises only in capitalist economies, because for capitalism private ownership is the essence of all businesses, and in particular that of small businesses, which is not the case in the socialist economies. Prior to the recent liberalisation in the People's Republic of China, private ownership was restricted to the fewest and smallest possible enterprises; while collective ownership was frowned upon and considered to be quasi-capitalist, and its workers forced to accept lower wages and fringe benefits than State employees. At that time the People's Republic of China, like other communist economies, did not have to deal with the issue of the relationship between ownership and management since, owing to the elimination of all private ownership, such an issue did not exist. Consequently, for a socialist economist, the chief distinction between big and small business was its size, and not the ownership-management relationship. The new developments in the People's Republic of China have, however, altered this. With the increase of non-State ownership,[11]

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11 "Collective Ownership: Bright Prospects", Beijing Review, No.28, July 13, 1979, p.4. Statistical data distilled from the above publication has provided the following information:
Towards the end of 1978 there were 20.48 million people working in collectively owned units in the PRC. The number of people working in State-owned industries was 74.51 million. This means that towards the end of 1978, out of a total of 94.99 million employees, 21.5% worked in non-State owned enterprises.

the relationship between ownership and management had to be thought out more thoroughly. Statements such as:

> "Enterprises under collective ownership are a component of the socialist economy under public ownership..."[12]

or:

> "State enterprises owned by the whole people are the backbone of the nation's industry and enterprises collectively owned by the labouring people constitute an important force that cannot be overlooked."[13]

or:

> "The question of which form of socialist ownership is better, or the question of long term co-existence between ownership by the whole people, ownership by the collective and other forms of public ownership, remains a question to be solved...Judging by the present conditions in our country, it is not advisable to talk imprudently about transition. Collective ownership, and ownership by the whole people should be allowed to support, learn from and emulate each other and exist side by side for a long time to come."[14]

indicate the urgent need for a reappraisal of formerly held views regarding the socialist economy of the People's Republic of China. In order to accelerate production and elevate the population's standard of living, it was necessary to manipulate the classical communist dogma of "the ownership of the means of production", so that it could accommodate also some private and collectively owned enterprises, in addition to State-owned ones.

For the capitalist economist, ownership is the starting point for a small business definition; whereas for the socialist, it is size. From such diverse starting points, dissimilar definitions are bound to evolve, but not necessarily different small businesses.

The correlation between the "smallness" of the small business and its joint ownership-management function has been studied by two capitalist

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12 Ibid.

13 Ibid.

14 Editorial in the Guangming Ribao, Beijing, as quoted in "Collective Ownership Bright Prospects", supra, p.5, note 11, p.157.

economists, Professor Schumacher and Professor Knight. Both started from the same economic principles, but formulated diverse definitions and concepts of small business and its role in a capitalist economy.

(ii) Professor E.F. Schumacher's Definition of a Small Business

Professor Schumacher's name has become widely associated with the small business world since the publication of his book **Small is Beautiful.**[15] He was the first economics theorist to deal directly and exclusively with this phenomenon, by isolating and identifying it as a unique institution, not merely a miniaturised replica of big business. His coinage of the phrase "Small is beautiful" on the lines of "Black is beautiful", reflected the spirit of the times, and indicated Schumacher's intention to give small business an identity of its own.

With the increasing dominance of big business in the world economy, and the introduction of sophisticated management techniques and their technologists, the prestige of small businesses and their owner/ managers has been declining. Objective researchers have portrayed the owner/ managers as possessing lower managerial skills than their counterparts in big industry.[16] They have been accused of paying lower wages[17] and providing inferior working conditions.[18]

Small is Beautiful was supposed to restore that tarnished image.

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15 E.F. Schumacher, Small is Beautiful, a Study of Economics as if People Mattered, Abacus edition, 1974. First published in UK by Blond and Briggs Ltd., 1973.

16 J.E. Bolton, Small Firms Report of the Commission of Inquiry on Small Firms, HMSO, London, Cmnd. 4811, Nov. 1971, p.8, 2.6-2.7.

17 Ibid., p.20, 2.38.

18 Ibid., p.21, 2.40.

But the author, among others,[19] has found that Schumacher's study has been often misunderstood. He has been assumed to advocate small business to the exclusion of big business,[20] to preach private ownership, entrepreneurship and capitalism, as superior to common ownership. Yet his published work does not support these mistaken impressions. It might have been that the catch-phrase of the title "Small is beautiful", combined with the political mood at the time, implied a philosophy which it did not actually proffer.

The sub-title of the book, "A Study of Economics as if People Mattered", conveys its contents more accurately. Schumacher postulated that the enterprise should serve human needs. But, in reality, human needs are directed to suit the organisation.[21] His concern was with the goals the enterprises had in relation to its human factors, and not with types of ownership. He argued that capitalist and socialist enterprises shared identical economic aims: increased production and viability. The fact that one was privately and the other communally owned did not separate them into different categories where human needs were concerned. He did not denounce private property, but distinguished between two types:

(a) private property which is an aid to creative work; and

(b) property which is an alternative to creative work.

The second type is "capital" ownership, which profits its owner without work:

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19 Rein Peterson, Small Businesses: Building a Balanced Economy, Press Procépic Ltd., Ontario, 1977, p.12.

20 Carl D. Goderez, "The World Bank in Small Business Development", paper presented at the International Symposium of Small Business, Washington, D.C., Nov. 15-18, 1976.

21 Douglas M. McGregor, "The Human Side of Enterprise", Readings in Managerial Psychology, (ed.) Harold J. Leavitt and Louis R. Pondy, Second edition, The University of Chicago Press, 1973, p.748.

> "There is something natural and healthy about the former - the private property of the working proprietor; and there is something unnatural and unhealthy about the latter - the private property of the passive owner who lives parasitically on the work of others."[22]

This way of thinking follows Tawney's, whom he quotes:

> "It is idle, therefore, to present a case for or against private property without specifying the particular forms of property to which reference is made... For it is not private ownership, but the private ownership divorced from work which is corrupting to the principle of industry; and the idea of some socialists that private property in land or capital is necessarily mischievous is a piece of scholastic pedantry, as absurd as that of those conservatives who would invest all property with some kind of mystic sanctity."[23]

By using the criteria of the function and purpose of ownership, Schumacher arrived at the conclusion that property owned by private enterprise, which is necessary for the work process, is automatically "small-scale, personal and local" and as such, is harmless to the employees and consumers who have dealings with it.

The small size requisite is one of Schumacher's imperative conditions. But in the absence of more definite restrictions, the optimal size was left open to interpretation, as each industry has its own relative small scale. For example,[24] in the US automobile industry, American Motors is a small business despite its being a billion dollar corporation and the largest employer in the State of Wisconsin. This example illustrates the relativenesss of small scale.

In order to curtail the size of an enterprise, Schumacher required it to be "local". By containing the scope of its economic activities within

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22 Schumacher, p.220, supra, note 15, p.159.

23 R.H. Tawney, The Acquisitive Society, The Fontana Library, Collins Clear-Type Press, London, 1961, as quoted by Schumacher, p.220, supra note 15, p.159.

24 Hearing before the Sub-Committee of the Select Committee on Small Business, United States Senate, 90th Congress, Second Session, on the question: "Are planning and regulation replacing competition in the American economy?" (The automobile industry as a case study), US Government Printing Office, Washington, 1968, p.17.

geographical boundaries, he hoped to curb its expansion. He foresaw situations where "small-scale" and "local" would not have been adequate determinants of a small business definition, and introduced a further qualitative element: that of "personal". The business had to be personal, in the familial paternal sense. It had to be conducted in a personal manner, and any degree of familiarity was welcomed, even to excess.

> "Even autocratic control is no serious problem in small-scale enterprise which, led by a working proprietor, has almost a family character. It is incompatible with human dignity and genuine efficiency when the enterprise exceeds a certain - very modest - size."[25]

The requirement that the management should be personal is not dissimilar to the one required by the UK Bolton Committee, though it must be emphasized that the Committee did not attribute to it the same importance. Schumacher's "personal" is the image of the autocratic working boss, who treats his employees as if they were his family. This concept of "personal" is old-fashioned, unrealistic and naïve. It is anathema to modern management and industrial relations theories, where the principle governing employer-employee relations is that employees have rights, not concessions distributed by a benevolent boss. Had Karl Marx been around, he would have surely lumped Schumacher together with Sismondi[26] in the same description, "... economist, petty-bourgeois critic of capitalism, exponent of economic romanticism".[27]

Schumacher's belief that autocratic yet personal relationships with workers were more welcomed than official structured ones, has received

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25 Schumacher, p.221, supra, note 15, p.159.

26 Jean-Charles-Léonard Simonde de Sismondi (1773-1842) was a Swiss economist.

27 Karl Marx, The Poverty of Philosophy (in English), Foreign Language Press, Peking, 1978, p.240.

only limited support, because there is no conclusive evidence showing the correlation between workers' job satisfaction and personal management.[28]

If cited out of context, the four basic elements of Schumacher's definition - (1) ownership of property needed for creative work; (2) small scale; (3) local; and (4) personal - do not manage to explain his total concept of the small business and its social function. Its value to humanity was not to be assessed according to normal industrial or economic criteria, as its importance was in its lack of harmful effect either on the environment or on the human elements who were involved with it. Small business, to use Schumacher's words, was "harmless", in contrast to medium and large business. It offended neither the consumer nor the employee. Thus, the one would not need State regulations to safeguard him, because the business's responsibilities to the consumer can be safeguarded by the consumer himself; while the other, the employee, would be protected by "legislation and trade union vigilance."

Schumacher's small business is a hybrid derived from the interactions between capitalist and socialist economic contradictions. It is not a typical product of free enterprise, nor is it a socialist construction or a total negation of capitalist ownership principles: it displays a half-hearted belief in socialism. In a world so clearly divided into "for" and "against", his brand of "intermediacy" was his own. If he intended his type of small business to be the link between the polarised economic systems, it was not attained.

His small business, which prima facie was a capitalist sponsorship, had more in common with small businesses in the People's Republic of China than those in the USA or Britain. The China of Mao Tsetung and

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28 Mitchell Fein, "Motivation for Work", in Handbook of Work, Organization and Society, (ed.) Robert Dubin, Rand McNally College Publishing Co., Chicago, 1976, pp.470-475.

the Gang of Four could have served as an example of a country where small private enterprises functioned according to the Schumacher model. Like his model of small business, theirs were allowed to produce restrictively, only in sufficient amounts to supply their owners' and their families' needs. The Chinese small enterprises, like Schumacher's small business, had to be "personal", as any employment outside the family circle was considered exploitative and was forbidden by law.

Had it not been for one difference, it could have been thought that Schumacher's small business had been reproduced from the Chinese model. Although both agreed that enrichment from "capital" was wrong, they disagreed on "enrichment" resulting from the employment of others, which in China was a taboo confirmed by law, but which Schumacher did not condemn. On the contrary, his small business employer had a certain mission, a sense of pride and responsibility in his ability to provide work and look after his charges.

Since October 1979 the People's Republic of China has, on the one hand, moved away from the Schumacher model of small business by encouraging the growth of collective ownership and the commercialisation of small enterprise, thus contradicting the Schumacher size and aim stipulation; but on the other hand, it has started to accept the concept of outside employment by collectively-owned small enterprises, and the wages remuneration of those employed by them.

An external manifestation of the difference between Schumacher's small business and that of the US definitions is to be found in the different growth potential of the two. Whereas Schumacher intended it to stay small, and not grow above a size needed to supply the needs of the owner and his family, the American small business is not restricted in its growth, as long as it is owner-managed and has a small market share. In certain industries it can and does employ 1500 people.

Schumacher intended his owner/manager to be an artisan, a craftsman, or, at the most, a small shopkeeper - whereas the American owner/manager is expected to be a businessman.

The different optimal sizes of the two are a result of their diverse avocations. The function of the American small business, as prescribed by legislation, is to guarantee the existence of "competition", without which it is feared that big business would dominate the economy to the detriment of the consumers and eradicate "free enterprise", which in the USA is more than an economic system - it is a way of life. In contrast to this, the role Schumacher had intended for his small business, was that of a small economic unit, supplying its owner/manager, his family and several employees with an adequate living standard, without exposing them to the demanding, unpleasant reality of production and commerce.

In the growth and success of the small business, Schumacher saw a threat to his doctrine of "ownership needed for creative work only":

> "The owner, employing salaried managers, does not need to be a proprietor to be able to do his work. His ownership, therefore, ceases to be functionally necessary. It becomes exploitative if he appropriates profit in excess of a fair salary to himself and a return on his capital on higher than current rates for capital borrowed from outside sources."[29]

To prohibit high profits and to discourage expansion, is to negate the very basic principles on which private enterprise and capitalism are founded. Schumacher's small business owner was not the entrepreneur who innovated or sought opportunities. He did not change direction according to new market demands, and did not possess the ability to lead and inspire others. He was a content craftsman-cum-trader, with no great

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29 Schumacher, p.221, supra, note 15, p.159.

financial aspirations, as described by Stanworth and Curran[30] in their book, **Management Motivation in the Small Business.** And therefore he had no need for "free enterprise" and the services offered by capitalism.

In order to understand the totality of Schumacher's small business concept, it is important to study his view about the medium and large enterprises:

> "When we move from small scale to medium scale, the connection between ownership and work already becomes attenuated..."[31] If there is only one owner or a small group of owners, there can be, and should be, a voluntary surrender of privilege to the wider group of actual workers... Such an act of generosity may be unlikely when there is a large number of anonymous shareholders, but legislation could pave the way even then."[32]

Although from the latter quotation, it might seem that he favoured the nationalisation of large enterprises, he did not actually prescribe it. On the contrary, he condemned both big private business and nationalised industries for robbing the worker from the gratifying sense of possession and personal relationship with his working environment.

The only meaningful ownership for Schumacher is a physical one, to which the owner can relate through actual usage or enjoyment; and not an abstract notion like paper shares: "In large-scale enterprise, private ownership is a fiction for the purpose of enabling functionless owners to live parasitically on the labour of others."[33] It ought to be pointed out that Schumacher did not object to big business as such. It is their mode of operation which he rejected, as it excluded involvement and participation through sense of possession, from those who worked in them.

His solution was workers' and producers' co-ownerships, modelled on the

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30 John Stanworth and James Curran, Management Motivation in the Small Business, Gower Publications, 1973.

31 Schumacher, p.221, supra, note 15,p.159.

32 Ibid., p.223.

33 Ibid.

Scott Bader Commonwealth Model.[34]

Schumacher's small-business origins can be traced to the European Artisanat Institute, which stipulated the knowledge and practice of a craft or skill, and in most cases limited the number of employees.

The German definition of the Artisanat stipulated that, "... the head of the enterprise (a manager in case of a company) must hold a master craftsman's certificate."[35] The French definition limited the number of employees to five engaged in production, processing, repairs or the provision of services.[36] The Italian definition of the Artisanat is very comprehensive, and uses qualitative criteria in addition to quantitative ones. The basic elements of the definition are:

1. commerce is excluded from Artisanat occupations;
2. limited liability companies are also excluded;
3. the majority of associates have to work in the Artisanat;
4. labour should be valued more than "capital";
5. the owner must be the manager, must take direct responsibility and must work manually in the Artisanat;
6. family members are encouraged to work in the Artisanat;
7. employment is restricted to between 5-10 workers and 5-10 apprentices, according to the occupation of the Artisanat.[37]

That the Italian definition contains the essences of Schumacher's small-business concept, including not only the technical requisites but

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34 Scott Bader & Co. Ltd., Wollaston in Northamptonshire, England. The owners transferred the ownership to workers. Trades now as Scott Bader Commonwealth. Professor Schumacher was a director of Scott Bader Commonwealth.

35 1953 Code for the Artisanat (revised in 1965).

36 Order No. 62-235 (Mar. 1, 1962).

37 Law No. 860 of July 25, 1956.

also the vocational ones, such as "labour should be valued more than capital", is self-evident. But what is more illuminating is that such a detailed definition has existed in Italy since 1956, which indicates that thousands of artisans must have been pursuing Schumacher's prescribed gratifying way of life, without gaining converts, or advocating its spread. Might not this suggest that Schumacher's "ideal" is not that idyllic after all?

(iii) Professor Frank H. Knight's Qualitative Definition of Small Business

The term "small business" is not to be found in Professor Knight's major theoretical economic study, **Risk, Uncertainty and Profit.**[38] Neither is a carefully worded definition of one, although a considerable part of the study deals with the role of the entrepreneur, whom he refers to as the "recognised central figure of the free enterprise system". From 1916, when Knight originally wrote the above dissertation, and up to 1921, when it was published, the generic name "small business" was not used as a business classification. The first use of the term in a legal context appeared in the USA **Selective Service Act 1948.**

Although "small businesses" were not recognised as a special classification, economists were not oblivious of their existence, or that they had different characteristics from those of large enterprises. Although there was then no search for a unifying common denominator to entitle them to be jointly classified, they were accepted as independent phenomena. The private company, the family business, producers' co-operatives and entrepreneurs were studied each on their own economic

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38 Knight, p.132, supra, note 8, p.155.

merits, rather than as a group. Later qualitative definitions, of small business, concentrating on the unique characteristics of this business form, have indicated the owner/manager as the key factor responsible for its existence. The entrepreneur, whose role in the economy was elucidated by Professor Knight in his aforementioned study, is the owner/manager of the small business definition.

Professor Knight's theories offer explanations of the two most crucial issues arising out of a small business definition, which are:

> the need to link management of property (capital, land, moveables, goodwill, etc.) to its ownership in order to achieve effective control;

and:

> the size limitation of an economic form where ownership and control are concentrated in one person.

By-products of the joint ownership/management are the "independent decision-making", the "personalised management", and the "risk-bearing" elements, which were mentioned by the qualitative small business definitions hitherto studied. Derivations from the small size are: the "small market share"; and the restrictions on the number of employees, amount of turnover and/or capital investments. These are jointly or separately the quantitative qualifiers for small business classification, by those countries that have a quantitative definition only.

It is proposed to introduce Professor Knight's arguments, and to construct from them a small business definition in accordance with his economic theories, as expressed through his presently discussed study.

Uncertainty, according to Professor Knight, is the predominant dynamic force in the regularisation and management of the economy;[39] the cause of this is the lack of perfect knowledge as to future occurrences and their consequences.[40] The running of a business involves

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39 Ibid., p.268.

40 Ibid., p.288.

making decisions of two kinds: those based on prior knowledge, which are referred to as "routine" and are the domain of the hired manager; and those required to be made without a prior cognitive basis, and which are related to the projection of requirements, anticipation of demands and the like, without which a business cannot exist, and which are referred to as entrepreneurial decisions. Without perfect knowledge, these decisions have to be based on personal opinions, the validity of which it is impossible to ascertain.

In an ideal, perfect, economic model, devoid of uncertainty, all decisions can be taken on the basis of knowledge, and therefore become routine. When only routine decisions are required, the status and remuneration of workers and managers are equalised, since both engage in repetitive functions, and the difference between them becomes one of degree and not of essence.[41] But as in reality, uncertainty governs economic life; and those individuals who can cope with uncertainty, express "opinions" and act upon them are in great demand, command high remuneration and lead enterprises. These are the entrepreneurs.

The reduction of uncertainty is the prime concern of industry. The development of better and quicker information gathering and dissemination methods, mathematical probability calculations, economic models monitored by computers to enable more accurate forecasting, and the division of "risk" by the diffusion of ownership through share issues are all measures to combat economic uncertainty.

It is suggested that if we accept that uncertainty is the great unbalancer of the economy, and efforts ought to be made to reduce it, then it is impossible to ignore the function of the "planned economy" system as a reducer of uncertainty. Planned economy removes the short term uncertainties from the producer, by dictating and controlling both

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41 Ibid., p.267.

the supply and demand of the market, thus allowing the producer to concentrate on the routine task of production. And because a planned economy reduces the short-term uncertainties, it needs a smaller number of entrepreneurs who are capable of coping with them than does an unplanned economy. The planned economy can therefore dispense with the entrepreneur, who is irreplaceable in the unplanned economy. The reduction of management tasks to routine decision-making blurs the demarcation between worker and manager and enables an interchange of roles between them without undue adjustment difficulties. Such a process took place in the People's Republic of China, reaching its apex during the Cultural Revolution, when workers insisted on their right to become managers.

In a planned economy, ideological reasons apart, the entrepreneur's role as a reducer of uncertainties becomes defunct, and even without political coercion he would have lost his economic raison d'être. In the People's Republic of China, unlike the Soviet Union where entrepreneurship was forcibly terminated, the transfer of the uncertainty-reducing function from the entrepreneur to the planned economy was allowed to take its course for fifteen years with minimal disturbance to the economy.

The entrepreneur reduces the uncertainties of the commercial world by assuming them upon himself. By doing that, he frees the managers and workers from that occupation, and enables them to carry out their production functions smoothly. Knight claims that in order to succeed in his role as "risk"-absorber, the entrepreneur has to own property, without which he is bound to fail in his allocated role.

The ability to take risks has not been vested solely in the entrepreneur. Many hired managers have demonstrated such a talent. Yet rarely have they been entrusted with this category of decision-making. Decision-making on its own is meaningless, unless it is followed by responsibility for its consequences. Responsibility cannot be assumed

merely on the willingness and agreement to accept it. What is looked for in responsibility is the ability to guarantee and compensate for the losses which could result from the decision-making. Compensation means money, which can be realised only from the owner of property. This is why an entrepreneur who has to take responsible decisions has to own property. Had he not been in a position to guarantee his decisions, they would have become ineffective, because they would not have carried the authority and trust needed to command others to abide by them. Consequently, he would not have been able to fulfil his functions.

In an industrial society, his function is to produce and/or provide services, for which he relies on the suppliers of raw materials and labour, i.e. workers. Both demand guarantees of his ability to respect his contractual obligations to them, in the absence of which they offer their services to the other entrepreneurs who vie for them.[42] It is thus the workers themselves who, in order to guarantee their remuneration, force the manager to own property and become an owner/manager. This reasoning relates to an entrepreneur who started as a manager, following which "uncertainty" forced him to become an owner too; and also to the entrepreneur who started as an owner, and was forced to become a manager as well.

In an ideal economy, without uncertainties, the owner of property could hire a manager who would manage through a series of routine decisions. In the true economy, the managerial task involves entrepreneurial decisions, taken on the basis of personal judgement. This could result in the owner of property being asked to trust the personal judgement of a hired manager, who would not be in a position to make responsible decisions, since they would not be underwritten by his ownership of property, which could act as a guarantee to his decision-

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42 Ibid., p.271.

making. The owner who cannot trust the decisions taken by a non-owner manager, because the latter would not lose anything as a result of his own decision making, has no option but to become the manager of his own property.

In a free-enterprise society, it is believed that better decisions are made when the decision makers' own property is at stake. Therefore, Knight insisted that the entrepreneur should not shield behind the limited-liability structure, through which his personal loss would be restricted, and would therefore not act as a deterrent against irresponsible decision-making.

It can be concluded that, according to Professor Knight, any person engaged in entrepreneurial decision-making, based on uncertainties, needs to be an owner/manager. And as all economic activities in a free enterprise society are faced with uncertainties, it follows that all enterprises ought to be headed by owner/managers. This would have been correct, had there not existed the question of a size limitation.

An enterprise headed by an owner-manager is bound to be limited in size on account of the following three truisms:

1. "...the chief limitation on size is the capacity of the leadership."[43]
2. "The greater the magnitude of operation which any single individual attempts to direct, the less effective in general he will be."[44]
3. "In view of the difficulty of any single individual giving adequate security for the performance of his contracts in the case of a large undertaking, such a form of organisation has a very limited opportunity for growth."[45]

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43 Ibid., p.283.

44 Ibid., p.282.

45 Ibid., p.299.

The essence of these truisms is that an enterprise headed by an owner/manager is self-restricting in size, as it relies on the supply of the following three resources which are vested in the owner/manager himself:

1. Capability.
2. Control.
3. Finance.

The more of these resources that the owner-manager possesses, the bigger his business could become; and the bigger it becomes, the more will be required. Not only should he possess these resources, he should also be able to supply them, simultaneously and in the correct ratio. The supply of only some of the resources, though in large quantitites, cannot compensate for the lack of others. And to achieve any size above small, all resources have to be supplied simultaneously, and in the correct ratios, for each phase of the enterprise's growth, and for the making of each decision. In rare cases, an extra dose of one can compensate, to some extent and for a limited time, for insufficiencies of the others. In such cases, the most effective compensator is finance, as it can buy for the enterprise the extra time needed to enable the owner/manager to learn and rectify his deficiencies of capability and control. Conversely the deficiency of financial supplies is the most critical for the enterprise, as it causes its failure without giving the owner/manager an opportunity to improve his ability and control.

It has been suggested, contrary to opinions held by owner/managers themselves, that the chief cause of small business failure is lack of management skills rather than lack of finance.[46] Professor Knight would have disagreed with this supposition, and would have argued that, as the owner/manager had to possess the aforementioned three qualifying

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46 A.M. Woodruff and T.G. Alexander, Success and Failure in Small Manufacturing, University of Pittsburgh, 1958, p.117.

resources - capability, control and finance - before he could become an owner/manager, he could not have lacked managerial skill (managerial skill = capability + control), though he might have needed to improve it. And as improvement is a quantitative matter of degree, this means that had the manager had sufficient financial resources to fall back on, he would have been able to "buy time" until he improved his managerial skills, and prevented the collapse of the enterprise. It follows, then, that the last blow decreeing the death of an enterprise is the lack of finance, and not the lack of managerial skills. Owner/manager-headed enterprises are doomed to stay small, because the chance that the three resources will rest in one entity, and be available simultaneously and in the correct ratios, is very slight.

A small business definition, in accordance with Professor Knight's perception of the enterpreneurial role, would have read as follows:

> **A small business is an enterprise headed by an owner/manager trading with unlimited liability.**

The proposed definition avoids arbitrary quantitative size restrictions, such as number of employees, sales volume or small market share; as well as qualitative specifications such as personal management. This is because, according to Knight, the "smallness" of the business is inherent in the owner/manager's personal limitations; and his relations with his workers are based on his ability to pay up, thus fulfilling his contractual obligations to them, and not on his style of management.

Risk, Uncertainty and Profit was written 63 years ago, during which time the free enterprise economies, including the USA, have undergone many changes. Most of them have blunted the harshness of the system, with its merciless effects on the human elements caught in its web. It is therefore amazing to realise that Knight's theories have withstood these changes; and with minor adjustment of degree rather than essence, his study would be valid as a description of today.

The changes which have affected Knight's theories are:

1. In most free-enterprise industrial countries of today, the State guarantees the worker a minimum living wage, which means that in cases where a business fails, and the entrepreneur is unable to honour his contractual obligation to the workers, the State steps in and takes over most of his financial duties to the workers. This reduces the entrepreneur's responsibility to honour his contractual obligations, and weakens his initial reasons for the necessity to own property as a guarantee of workers' wages. Therefore, today, unlike in 1916, the worker has shifted his main emphasis from remuneration to working conditions and work satisfaction.

2. The State's guarantee of minimum wages has also altered the relationship between entrepreneur and employees from the stark contractual obligation described by Knight to co-operation. The worker who is no longer that dependent on remuneration expects from the entrepreneur not merely an adherence to a contract of employment, but also a human relationship.

3. The sophistication of modern management techniques and the introduction of computers have revolutionised decision making. It is not suggested that uncertainty has been eliminated, but merely that more decisions, previously the entrepreneur's speciality, have become routine ones. These days an owner of property, as a result of inheritance, luck or toil, is not necessarily the best manager of his own property. The saying that "a person thinks best when his own property is at stake" is no longer valid for most ownership cases. Since more areas of decision making have become routine, and others, owing to complicated government regulation and taxation labyrinths, have become the experts' domain, there is no reason to suggest that a manager of his own properties will achieve better results than a hired manager. This argument, too, weakens

Knight's property-management link.

4. The present acceptance of the moralistic attitude that owners of property should not profit unduly further relegates management's decisions into the routine category and weakens the ownership-management link.

5. It has become a fact that "planned economies", for better or for worse, are working propositions. This economic form, not yet developed in 1916, managed to dispense with entrepreneurial services and, in doing so, broke the link between ownership and management. This, however, does not lessen the profoundness of Knight's understanding of the entrepreneurial role as a reducer of uncertainties. On the contrary, provided that uncertainty is part of the economic system, it is a further confirmation of his view. But in an "economic system" which reduces uncertainties, the entrepreneur's role, on economic grounds, is defunct.

Conclusion

If Schumacher is an idealist, then Knight is a realist. Schumacher advocates, whereas Knight analyses. It is easier to accept an explanation of tomorrow's events if they are similar to yesterday's and today's, than embrace a tomorrow not encountered before.

The merchants of "ideals" must rely on other attractions than the utility and practicability of their wares, since their attributes are as yet unexperienced. They have to, and do, appeal to our sense of justice and humanity. Those who manage to combine utility and humanity in their promotion clinch the deal.

Schumacher is not among them.

The merchants of "reality" explain relationships and connections. We purchase, if we like the explanation. Whatever their explanations are, they do not claim to change reality - just to explain it. They are

humbler people, easier to trust. Some would say less courageous. To compare one with another is to compare differences, not similarities. Not that it is impossible, but it is purposeless, because the one is revered for his sharpness of sight, the other for the range of his vision; the one is a leader, the other a consolidator; yet both complement each other and, in doing this, widen our own scope of perception.

CHAPTER TEN

SMALL BUSINESS DEFINITIONS BY SOCIAL PSYCHOLOGISTS

Introduction

An economic definition of small business ought, by its self-imposed disciplinary restrictions, to rely only on economic criteria. Yet Professors Schumacher and Knight, in their definitions of the small business, had to refer to the "entrepreneur" himself, and not merely to his business activities. Their correlation of the "entrepreneur" with the small business mirrors the accepted notion that in a small business there exists a close identification between the interests of the owner/manager and those of the business. This view ignores the fact that many small businesses operate as corporations, which are separate legal entities from those of their owner/managers.

Davies and Kelly[1] in their report to the Bolton Committee, quoted Kaplan:[2] "... small business means typically, an identity of management and ownership." They also referred to Oscar Grunsky, who saw the welfare of the firm and that of its owner/manager as intertwined.[3]

Because of the unity of interests between the owner/manager and the business, social and psychological criteria are relied upon in some definitions of small business, in addition to the economic criteria.

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1 J.R. Davies and M. Kelly, Small Firms in the Manufacturing Sector, Report No.3, Committee of Inquiry on Small Firms, HMSO, London, 1972.

2 A.D.H. Kaplan, Small Business, Its Place and Problems, McGraw Hill, New York, 1948, p.17.

3 Oscar Grunsky, "Corporate Size, Bureaucratisation, and Managerial Succession", American Journal of Sociology, Nov. 1961, p.226.

Social psychologists see the key to understanding the small business in the personality of its owner/manager and his managerial function. Placing the responsibility for the existence of the small business on the personality of its owner/manager links the size of a business to the personality of the entrepreneur and relegates to a secondary position the economic criteria which would otherwise be the essence of a small business definition.

(i) Variety of Definitions

Most definitions of small business proffered by sociologists, industrial psychologists and behaviourists, emphasise their managerial characteristics, and though many of these are agreed upon by all definers, the definitions themselves are dissimilar, - either because of the different weight attributed to the various characteristics, or on account of disagreement as to their actual existence.

The definition offered by Hollander revolves around the centralisation and concentration of managerial tasks by the owner/manager. He describes small businesses as:

> "businesses in the sense that they involve all or most of the business functions and decisions concerning production, marketing, financing and management; and do not exceed a size which considering the nature of the business, permits personalized management in the hands of one or a few executives, as opposed to the institutionalized management characteristics of larger enterprises" ... "self initiated, largely self financed and self managed".[4]

Kaplan accentuated the centralised control, and introduced the factor of personal relationship between worker, employer and customer. He did not, however, commit himself to judging the value of these relationships to the small business itself, but limited himself to their observation only:

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4 E.D. Hollander and others, The Future of Small Business, Praeger, New York, 1967, pp.4-5.

> "Small business means, typically, an identity of management and ownership, an absence of specialized staff for separate functions and facilities designed specifically for research and analysis, inability to finance itself through sources such as investment bankers, a personal relationship between owners and employees and customers, the affiliation of the firm with a local community, and chief dependence for its market on the local area. These factors, when present in combination, make small business recognizable as such even when its volume of business is substantial."[5]

Kets de Vries did not contain himself to mentioning the "personal" management, which typifies the small business, but detailed its meaning and manner of application:

> "What we frequently encounter in an entrepreneurial organization is an organizational structure and work environment completely dependent and dominated by the entrepreneur. The enterprise is run in a very autocratic, directive way whereby all the decision making processes centre around the entrepreneur."[6]

He went on to enumerate all the unsavoury manifestations of the "personal" management style:

> "We are also faced with an individual who refuses to delegate, is impulsive, lacks any interest in conscious analytical forms of planning, and engages regularly in bold proactive moves ... makes no distinction between day-to-day decision-making and more long-term strategic moves ...lacks deliberation and judgement ... This situation contributes to a high incidence of role conflict and role ambiguity leading to low job satisfaction, low self-confidence in the organisation."[7]

Such extreme criticism of small business management techniques, by Kets de Vries, demonstrates the extent of the disagreement among social psychologists as to the meaning of a small business.

Although all three definers have based themselves on social and psychological criteria, and have agreed that the small business was founded on the entrepreneurial type and his personal management style, they have offered three differing definitions of the same defined.

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5 Kaplan, supra, note 2, p.179.

6 Kets de Vries, "The Entrepreneurial Personality. A Person at the Crossroads", The Journal of Management Studies, Feb. 1977, p.35.

7 Ibid.

The discord between the three definitions cannot be blamed on the type of criteria chosen; for, as we have seen, the use of economic criteria, which are easier to monitor and verify than social and psychological ones, has also resulted in differing definitions of small business.

The variation in the definition can be due to one or more of the three following possibilities:

1. that the definers did not actually define an identical defined, though they believed they did;
2. or that each of the definers observed a different part of the defined characteristics, and did not discover their common features;
3. or, that the definers did observe the same defined and the identical characteristics in each, but then used their own personal interpretation to describe them.

Since social and psychological criteria cannot be accurately measured, they rely on the personal interpretation of the definer to a greater extent than economic criteria which, because theoretically they can be measured more accurately, are consequently more objective. In the present situation the interpreted observations are those of the "entrepreneurial type" and the "personal" management" style.

(ii) Entrepreneurial Types

A general definition of entrepreneurs will include all non-professional self-employed persons, while an economic definition is that of a contractor acting as an intermediary between capital and labour.[8] In the context of small business definitions, the entrepreneur is synonymous with the owner/manager.

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8 The Shorter Oxford English Dictionary, 1977.

A study conducted by Smith[9] distinguished between the two types of owner/managers - the "craftsman entrepreneur" and the "opportunistic entrepreneur".

The "craftsman entrepreneur" was found to be of a limited and narrow educational and training background, and of low social awareness and involvement. He lacked flexibility and confidence, and his time orientation was circumscribed to the present and past. He was reluctant to delegate responsibility or authority, and was anxious to limit the hiring of employees to people he knew personally, or at least to friends. He was averse to employing external sources of finance, aggressive marketing strategy, or engaging in any long-term planning of the enterprise's future. Smith has observed that this type of entrepreneur tends to build a formal organisation, characterised by rigidity. These characteristics are similar to the ones Kets de Vries found in his entrepreneur. But whereas Smith attributed these symptoms only to one class of owner/manager, to the "craftsman entrepreneur", Kets de Vries generalised, and condemned the whole breed conclusively, without appeal or remission.

The "opportunistic entrepreneur" was found by Smith to be of a broad education and training, and of a high social awareness and involvement. He was flexible and confident, and had an acute awareness and orientation of the future. He was ready to delegate, and as his company grew, hired on a universalistic basis. He utilised a variety of financing sources, employed an aggressive marketing approach and undertook long term planning of his enterprise's development. Consequently, his company was more growth-orientated than the craftsman-entrepreneur's firm, and tended to evolve an adaptive and flexible organisation.

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9 N.R. Smith, The Entrepreneur and His Firm: The Relationship Between Type of Man and Type of Company, Bureau of Business Research, Michigan State University, 1967.

As a result of Smith's observations, it is possible to draw the following conclusions:

1. Different types of entrepreneurs account for the different characteristics observed in small businesses by various definers.
2. The degree of centralisation and of concentration of management depends on the entrepreneurial type of the owner/manager.
3. "Personal management" is not an automatic by-product of an owner-managed enterprise. The fact that it is not practised by big businesses, due to their size factor, does not necessarily imply that it must be, or is, practised by small businesses.

(iii) Personal Management

"Personal management" is considered to be a characteristic of small enterprises, despite the lack of evidence to prove that either all, or the majority of, small businesses practised it. On the contrary, there exist sufficient data to show that many factors determine which type of business and at what size and stage of its development, relies on personal management.

Some of the determining factors are:

1. The personality of the owner/manager.
2. The age of the enterprise.
3. The size of the enterprise.
4. The physical size of the plant.
5. The type of industry and technology employed.

The relationship between the personality of the owner/manager and the use of personal management was dealt with in the previous section relating to entrepreneurial types.

The age[10] of an enterprise was found to be a factor in differ-

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10 Davies and Kelly, supra, note 1, p. 179.

entiating between personal and non-personal management styles. Family firms, in which personal management was traditionally practised, have changed to more formal managerial techniques once the founders were replaced by the second generation of owner/managers.

Size, too,[11] contributed to differences in managerial style and organisational structure. The management of a "small business" with 1500 employees[12] and the management of a "small business" with 50 employees[13] are bound to rely on different management techniques. That both might be considered small businesses, each in the context of its specific industry, does not alter the former assertion.

The relationship between employees and employers was found to be better in the small businesses, where workers received more job satisfaction.[14] It was thought that changes in the size of a business demanded changes of its management style and structure, and it was suggested that in order to maintain efficiency, these ought to be implemented before it reached the 200-employee size.[15]

Sadler and Barry pointed out that while charismatic leadership might suit the initial stages of a business's development, which is marked by fast growth and policy changes, it was not appropriate for an established and organised set-up.[16]

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11 Ibid.

12 Businesses in the petroleum industry of the USA are considered "small" if they employ fewer than 1500.

13 The number of 50 employees has been used by many countries in their quantitative definition of small businesses. This was concluded by Auciello, Johnson and Wagenveld, in their International Compilation of Small Scale Industry Definitions, Georgia Institute of Technology, Atlanta, Georgia, Project B-414, Jan. 1975.

14 S. Talacchi, "Organisation Size, Individual Attitudes and Behaviour. An Empirical Study", Administrative Science Quarterly, Dec. 1960, as quoted by Davies and Kelly, p.49, supra, note 1. p. 179.

15 Davies & Kelly, p.52, supra, note 1, p. 179.

16 Philip Sadler and Bernard Barry, Organisational Development: Case Studies in the Printing Industries, Longman, 1970, p.45.

The physical size of an enterprise was found to affect worker-employer relations. Small size of plants imposed a close contact between workers and management. Cleland, in a study conducted in the USA, reported fewer strikes in small plants, where an atmosphere of intimate contact enabled a personal knowledge of the employees and their needs, and contributed to good labour relations.[17]

In industries where personal management was an advantage, it was used, and where it was a disadvantage, it was ignored. In sectors which dealt with uncertain markets, subject to frequent changes in demand, such as the fashion industry, personal management with its unstructured procedures, proved an advantage.[18] There the high degree of management flexibility typical of personal management, enabled quick decision-making, which contributed to increased business. The latter was sometimes achieved at the expense of big business, whose decision-making was slower, because of its structured management.

Industries where personal management was not used, regardless of size, were those based on advanced technology. Joan Woodward showed a connection between organisation and the technology employed.[19] The more complex and advanced the technology employed, the more formalised was the management structure.

The assembled data indicate that personal management, although practised by many small businesses, is not practised by all, or the majority of them, and therefore cannot act as a common denominator in the definition of small business.

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17 Sherrill Cleland, The Influence of Plant Size on Industrial Relations, Research Report Series No.89, Princeton University, 1955, p.62.

18 Davies and Kelly, supra, note 1, p.179.

19 Joan Woodward, Management and Technology, HMSO, London, 1958.

SECTION B

THE QUANTITATIVE DEFINITION

CHAPTER ELEVEN

QUANTITATIVE DEFINITIONS OF THE SMALL BUSINESS

Introduction

All countries which define small businesses rely on quantitative criteria, and while some use these exclusively, others use them in conjunction with qualitative criteria. The reason for the extensive use of quantitative criteria is that the main function of these definitions is to serve as a basis for government statistics relating to employment, productivity, economic growth, export, taxation, and financial assistance. And, because the small business definitions serve such diversified aims, their quantitative criteria and numerical determinants vary from one legislation and programme to another. The criteria most often used are: number of employees, sales volume, profit, assets, and payroll.

A research[1] which undertook to find out about small business definitions in 75 countries discovered that none had an exclusive qualitative definition, but that all had a quantitative one. Out of these 75 countries, only six used a qualitative definition in addition to the quantitative one. Such an overwhelming use of quantitative criteria in preference to qualitative cannot be dismissed as accidental, or explained merely on the grounds of convenience for practical operation. There must be a more profound reason for this, and it is suggested that the countries concerned chose the quantitative criteria in preference to the qualitative deliberately, because they believed the former to be more appropriate for defining a small business.

The explanation of why quantitative criteria are more opportune to the small business is to be found in the workings of the Equilibristic

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1 K.E. Auciello, R. Johnston and L.M. Wagenveld, An International Compilation of Small Scale Industry Definitions, Georgia Institute of Technology, Atlanta, Georgia, Project B-414, Jan. 1975.

Decision-Making System (EDMS),[2] which maintains that most phenomena are of a secondary nature, and as such should be defined exclusively by quantitative criteria. And as small business is recognised by the Equilibristic Decision-Making System to be a phenomenon of secondary nature, it is natural, and therefore also acceptable, that it should be defined according to quantitative criteria. As most phenomena are not major, it seems that qualitative criteria are the exceptions, and the quantitative ones the rule. Yet, had it been argued and proven that small business is a major phenomenon, then according to the Equilibristic Decision Making System it would have attracted a qualitative definition.

To win converts to the idea that small business is a major and not a secondary phenomenon is a difficult, though not an impossible, task. It is difficult because the opinion of the defined, being the small business, is immaterial to the definer. That the defined assesses itself as a major phenomenon, has little bearing on the definer, whose own assessment is the only one that counts.[3]

The juristic definer does not share the freedom of his scientific colleague, whose qualifications for the task are deemed to be adequate as long as he defines what he believes to exist in accordance with his own knowledge and understanding.[4] The juristic definer has to consider the environmental surrounding and familial groupage of the defineds, and to ensure that the new definition does not duplicate an already existing one. The definition of each defined in the context of its relation to other defineds and definitions is imperative if the juristic definer is to guarantee a continuous harmony of unconflicting definitions. In the context of its economic surroundings, and its place in the family group of businesses,

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2 The Equilibristic Decision Making System (EDMS) is set out on pp.73-79.

3 The "definer" - "defined" relationship is stated on pp.53-54.

4 The tasks of the scientific and juristic definers are detailed on pp.52-57.

small business is a phenomenon of secondary importance, because the issues it raises, and the problems it faces, are not unique, but are similar to those of others within the same family group.

The majority of issues raised by small business require quantitative solutions of the "more or less" type, rather than the fundamental qualitative remedies of "what and where". Most definitions that deal with "more or less" issues, belong to the administrative domain, which in the realities of the small business world is a closer associate than the judicial one. Contact between small business and the administrative definer and applicator is more frequent than its contact with the juristic definer and the judicial applicator. Therefore, because the administrative definer and applicator are empowered to use only quantitative criteria, it is reasonable that a small business definition should be composed of the same criteria as they use. That this is what actually takes place in reality has been demonstrated by findings from the 75 researched countries.[5]

(i) Quantitative Criteria Used in Small Business Definitions

A basic distinction between the types of quantitative criteria used in the direct or indirect definition of small business, would be into human and monetary criteria. To the former belong the quantifiable human elements which are involved in the small business, such as employees, customers, subscribers or shareholders. To the latter belong the monetary elements such as turnover, payroll, capital investment, and profit; these act as indicators of the financial standing of an enterprise, which is not reflected by the human criteria. And as the end product of any business revolves around monetary results, it seems opportune to use monetary criteria for its definition. However, inflation causes monetary criteria to

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5 Auciello, supra, note 1, p.188.

lose their practical effectiveness as indicators of the financial standing of an enterprise and, consequently, of its size. In order to re-establish the reliability of the monetary criteria as indicators of financial achievements, it would be necessary to establish means of continuous revaluation of the original thresholds, by indexing them to the rate of inflation or to the rise in the cost of living.[6]

When the definition is a juristic one, in the sense that it was authorised by the legislator, such updating of the monetary thresholds takes place, though not at the desired frequency, on account of the slow working of the mechanism enabling such alterations.[7] When it is a scientific definition, however, which has not been incorporated into any legal rule or regulation, and has not been submitted to an established procedure of alterations such as an indexation to inflation, such updating does not take place. Consequently, such scientific definitions that relied

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6 S. Dombrovsky, "The Potential of the Israeli Small Industry in a Macro-Economic Context", Report (in Hebrew) submitted to the Israeli Institute of Productivity, June 1976, p.15.

7 An example of the updating of monetary thresholds can be found in the USA Small Business Administration regulations, as authorised by the Small Business Act of 1953, where sales-volume thresholds were used as the determinants for small-business status for several assistance programmes. On Aug. 5, 1975 FR 32826 has raised the sales volume threshold for the purpose of loan standards as follows:

(a) Industries relating to crops, from $250,000 to $275,000
(b) Wholesale trade non-durable Goods, from $5m to $9.5m.
(c) Retail trade auto dealers and gas stations, from $1m to $2m.

For concerns primarily engaged in construction, the sales volume determinant was first increased on Feb. 10, 1976 by FR 5809 to $5m; and subsequently, on Jan. 8, 1979, by FR 1725 to $9.5m.

An example from the UK, where the monetary thresholds have been altered to account for inflation, is the profit thresholds of reduced Corporation Tax of 42%, which have been raised since 1973 by the subsequent Finance Bills, as follows:

Finance Bill 1974 - £20,000.
Finance Bill 1975 - £25,000.
Finance Bill 1976 - £30,000.
Finance Bill 1977 - £40,000.
Finance Bill 1978 - £50,000.
Finance Bill 1979 - £60,000.

on monetary criteria have become outdated and meaningless.[8]

In comparison with the monetary criteria, the advantage of the human ones is that they are not affected by the changes in the monetary values, and therefore can be relied upon as more stable indicators of size. Yet despite this advantage, they have not monopolised the small business definitions, for there seems to be a pattern in the choice of criteria, whereby they are related to the specific purpose of the definition.

For example, when a small business is defined for the purpose of Corporation Tax, which is levied on profits, a profit criterion is used,[9] and when it is defined for Value Added Tax, which is calculated on the turnover, then a turnover criterion is used.[10]

(ii) Administrative Advantages of Quantitative Criteria

The administration derives three advantages from the use of a quantitative definition: clarity, directiveness, and adaptability.

The clarity is expressed in the numerical specification of the quantitative criteria. A ceiling, or a threshold, expressed by a definite numerical limit, is less likely to become an issue for interpretations or opinions than an abstract qualitative condition. The certainty attached to a numerical specification eliminates ambiguity, which in turn reduces bureaucratic discretion.

A quantitative definition, such as the one formulated by the Bolton Committee, which fixed the upper limit of a UK small business to 200

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8 The monetary criteria used by the Bolton Report in 1971 for the definition of small businesses in the retailing, wholesaling, motor trades and miscellaneous services categories have not been updated since.

9 The United Kingdom Corporation Tax is levied on profits. The definition of the exempted corporation is therefore based on a profit threshold.

10 Value Added Tax is collected on the sales figures of an enterprise. The definition of those exempted from the tax is also based on the sales figure.

employees,[11] or that of the UK **Companies Act**, which limited the number of shareholders of a private limited company to 50 persons,[12] does not allow the administration, or the judiciary for that matter, any discretionary powers. A state of affairs whereby the administration has to follow pre-determined guidelines, rather than use improvised discretion, is the aim of every democratic legal system.

In contrast with the in-built clarity of the quantitative definition, a qualitative one which used, for example, the criterion of "owner/manager", attracts many interpretations that cause its diffusion and prevent it from serving as an effective definition. Examples of such interpretations commence with the classic "self-employed" person, who manages no one but himself, and end with an Israeli kibbutz, or an advanced commune in the People's Republic of China, where it can be claimed that the members are in effect its owner/managers, as they themselves manage the joint property, to which they all claim a title. Such qualitative definitions are impractical as administrative tools, because they thwart standardised decision-making, and prolong their completion cycle.

The clarity of the quantitative definition facilitates the administration's executory tasks by providing unambiguous numerical specifications, which eliminate the time consumed in bureaucratic discretionary decision-making, and its repetitive self-duplication. At the same time, it also acts as the legislator's watch-dog over the administration's range of discretionary powers.

The directiveness of quantitative criteria is expressed in their ability to be used by the administration as directors and/or diverters of

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11 The quantitative specification of 200 employees is only part of the definition. The other specifications are qualitative.

12 Companies Act 1948, Sec.28(1). This condition has been cancelled by the Companies Act 1980.

economic policies. This ability stems from the fact that quantitative criteria, unlike qualitative ones, are not static, and as such the alteration of their numerical thresholds in no way affects the fundamental characteristics or functions of the object which they set out to define. For example, the basic function of a business - to convert capital, material and labour into marketable end products - does not change with the increase or decrease in the number of its employees, or that of its turnover. Its function stays constant, despite the numerical alteration to its composing elements. This ability of quantitative criteria to vary the numerical specifications without changing the function of the defined has made the quantitative definition instrumental in the direction of the economy.

The occasions when quantitative criteria have been used for their capacity as economic directors are numerous. In 1965, 1966 and 1967, when the then Labour Government, headed by Mr Wilson, sought to improve the UK balance of payments, it encouraged exports by introducing an Export Rebate scheme, which correlated the export sales figure of an enterprise with a cash incentive, calculated as a percentage of the export sales.[13] In 1978 one of the measures taken by the Labour Government to increase employment was the introduction of the Small Firms Employment Subsidy Scheme, according to which enterprises employing less than 200 which managed to offer additional jobs were given a financial subsidy for each additional person they employed.[14] Successive Governments have tried to encourage

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13 (a) Customs and Excise. The Export Rebates Order 1965, No.34.
(b) Customs and Excise. The Export Rebates (Rates of Rebate) Order 1966, No.1540.
(c) Customs & Excise. The Export Rebates (Rates of Rebate) Order 1967, No. 1834.

14 The Employment Subsidies Act 1978 authorised the Secretary of State to use his discretion in the setting up of schemes for paying employers to retain employees who would otherwise become redundant, or to engage new ones. Prior to this Act, the Secretary of State devised the Small Firms Subsidy Scheme, in accordance with Section 5 of the Employment and Training Act 1973.

small businesses by levying a reduced tax rate on those with lower profits.[15]

Through the use of quantitative criteria, the administration can change its policies without the legislators' specific approval. This freedom of manoeuvre is welcomed by the bureaucracy, who consider it essential for the conduct of effective government, especially for situations when new economic measures have to be taken swiftly. As the use of quantitative criteria by the administration grows, so does the legislator's concern over it, because quantitative criteria - the tools that enables the administrator to function more effectively - render him also less accountable.

The adaptability of the quantitative criteria is asserted in their capacity to be applied to different defineds. The same quantitative criteria can be used to define varied industries in diverse locations, merely by changing their numerical thresholds. Different industries might require different levels of workforce, capitalisation and sales volume. By adopting a variety of quantitative ceilings, each correct within its sector, a quantitative definition of a small business can equate a business employing 1000 persons, such as in the USA air transport carrier industry,[16] with one employing 250 people, such as in the boat building and repairing industry,[17] so that both can be considered as small businesses for the purpose of government loans. It can also equate small businesses from different-sized economies, by taking into account the overall size of a country's economy. An Israeli small business of 50 employees, or a UK

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15 In the UK, since 1973, the yearly Finance Acts have used tiering in the imposition of Corporation Tax. Those companies with lower profits (changed yearly) were taxed at 42%, whereas the rest at 52%. See supra, note 7, p. 191.

16 Anthony S. Stasio, The Study of Small Business, Office of Advocacy, US Small Business Administration, 1977, p.257.

17 Ibid., p.250.

one of 200 employees, can be equated to mean the same in the context of the relevant size of each economy.

From the administration's point of view, a quantitative definition has no disadvantages. This must account for the scarcity of qualitative definitions, the lack of which has not hindered any administration from carrying out government policies, aimed at assisting or taxing small businesses. Even those few countries which have a qualitative definition of small business, have supplemented it with quantitative criteria. This is the case in the Federal Republic of Germany, the UK and the USA. In the latter, the qualitative definition of the **Small Business Act 1953** (as amended), is reinforced by quantitative criteria known as "size standards", which vary from industry to industry, from programme to programme, and from regulation to regulation. These size standards are often reviewed and altered as a result of economic and monetary changes, lobbying by industrial sectors, and appeals by those who were excluded from the definition.

(iii) Criticism of Quantitative Definition

The criticism of the quantitative definition comes from two quarters: from the affected, being the small businesses who are the applicants of the definition; and from the affectors, who are its administrative applicators. The dissatisfaction arises on account of the ambiguity and inflexibility of the quantitative definition. The charge of ambiguity is supported by the applicants and the administrative applicators alike; whereas the accusation of inflexibility is brought only by the small business itself.

The ambiguity is due to the multitude of criteria and numerical specifications used in the different definitions of the same defined. These impede the administrative applicator's ability to match the definition to the correct applicant, and vice versa. They also prevent small businesses

from ascertaining their correct status and classification. If, within its own national legal system, a business can find itself being defined as a small business by one quantitative definition, a medium-sized enterprise by another, and a large one according to the third, then it would naturally be expected that different legal systems would provide dissimilar definitions. The same 500-employee business, which in the USA would be considered to be a small business, would be deemed to be of a medium size in the UK and the People's Republic of China, but large in Israel.

It is important for a business to evaluate correctly its own, and its competitor's, size and status classification. The adjectives "small" or "big" carry a wider implication than a mere physical description, because they are correlated with the availability of financial resources, and the ability to withstand recessions. They also indicate production standards and marketing capabilities, as they do the calibre and reliability of its management. Because quantitative criteria are expected to act as easily recognisable status indicators, they ought to be uniform and reliable. But when alternating formations of diverse indicators are used to describe the same phenomenon or status, a business is bound to become disorientated and confused as to its own true status, and to that of its rivals. And because the small business is not aware of its correct standing, it is often ignorant as to its dues or obligations under the different laws. An enterprise which is unaware of government regulations exposes itself to a precarious compromising situation which can endanger its entire existence. This is true regardless of a business's size, but it is even more so when the enterprise is a small one, so that its existence is already precarious. Furthermore, an incorrect status assessment of a business can have grave economic results, as there is nothing worse for the well-being of an enterprise than a small business undertaking big business obligations, and a

big business contracting into the mentality of a small one.

It is ironical that by being indifferent to the needs of small business, those countries which have not bothered about specialised legislation for them have avoided the pitfalls of ambiguous definitions.[18] In contrast a country such as the USA, which has devoted special Acts and regulations to small business, and has endeavoured to allot them a favoured status, has at the same time managed to create total ambiguity as to their meaning. The Small Business Administration[19] uses five different quantitative criteria, eight different definitions, and scores of numerical ceilings within each criterion, for the definition of the same defined, namely the small business.[20] In a comparison of USA size standards between two government assistance programmes for small businesses, the Financial and Procurement Assistance Programs, it was found that although the same criterion was used for the whole industry, the numerical standards varied in 41% of the sample.[21]

From the point of view of both the applicant and the administrative applicator, the ambiguity of the quantitative definition nullifies its professed advantages as a recognisable status indicator.

The charge of inflexibility is levied against the quantitative definition because of its inability to deal satisfactorily with exceptional situations. Usually, an enterprise is not concerned with the definition

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18 Israel, and to a lesser degree the UK, are countries where small businesses do not benefit from significant governmental assistance.

19 The Small Business Administration is a Governmental Agency created by the USA Small Business Act of 1953, Sec.4(a).

20 Norman Karsh, "What is a Small Business?", The Study of Small Business, Office of Advocacy, US Small Business Administration, 1977, p.179.

21 Ibid., p.183.

allocated to it by the definer, except when the definition is a determinant for governmental privileges or duties. When it is used for statistical purposes, or for inter-governmental distribution of responsibility, its numerical determinants are regarded by the defined as mere technicalities. But when an inclusion in or exclusion from the definition is liable to alter a business's balance sheet, or even its survival chances, the reasons for that inclusion or omission become a major concern to the affected sector. It is then that the inflexibility of the numerical thresholds of the quantitative criteria is experienced by the defined.

The administrator's lack of discretion to overstep, alter or overule the numerical standards imposed, earned the quantitative definition the label "arbitrary".[22] The same curtailed administrative discretion, which gained the quantitative definition its praise, as the controller of executive powers, has also earned it its criticism of arbitrary dispensation. Despite the arbitrariness of the numerical determinants of a quantitative definition, the injustice ensuing from them is relatively small, and most probably does not exceed that created by a qualitative definition.

(iv) The Arbitrariness of the Quantitative Definition

Each decision or every definition creates a barrier between those included in it and those excluded from it. This means that the affected are not only the included but also the excluded, or in other words, the totality of the group or sector to which the defineds belong. And as it is improbable that the whole group or sector, without exceptions, would be affected favourably by the definition, it is inevitable that those adversely affected would consider that decision or definition as arbitrary. This

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22 J.R. Davies and M. Kelly, Small Firms in the Manufacturing Sector, Committee of Inquiry on Small Firms, Research Report No.3, HMSO, London, 1972, p.47.

truism applies to qualitative and quantitative definitions alike. To charge only the latter with arbitrariness and absolve the former is incorrect. The difference between them is not that one is arbitrary and the other is just, but that one is more blatant about it, and the other more discreet. While the qualitative definition is merely arbitrary, the quantitative one is also seen to be so. Every layman realises the arbitrariness of a numerical determinant, but only the expert discovers the arbitrariness of the qualitative one. Arbitrariness is tantamount to a lack of alternatives, and its severity is measured by the numbers of those it has deprived of them. "Alternative" is a sensitive key factor in the structure of the ethical and legal systems of the western democracies. Any attempt to deprive a system of this factor is faced with strong opposition and claims of arbitrariness.

(a) Degress of Arbitrariness

The degree of arbitrariness of a juristic quantitative definition depends on three factors:

1. the number of alternatives it offers the applicator, which is an internal factor of the definition;
2. the number of applicants seeking inclusion in or exclusion from the definition, which is an external factor; and
3. the subject-matter which necessitated the definition, which is a pre-determined factor.

The first of these factors, which is the number of alternatives that the definition offers the applicator for his decision-making, stems from the actual structure, or the formation of the numerical determinants of the definition. That is to say that the manner in which the definition presents the numerical determinants has a bearing on the number of alternatives which it offers. This factor is considered an internal factor because it stems from the formation of the numerical determinants within the definition.

The second factor - the number of applicants seeking inclusion in or exclusion from the definition - depends on reactions from those affected by the definition, which are not known prior to or during its formulation, and emerge only after its promulgation. Because this factor is prompted by forces outside the definition, it is regarded as an external factor.

The third factor influencing the arbitrariness of the quantitative definition depends on whether its subject-matter is the imposition of duties or the granting of privileges to the defined, since each is endowed with its own degree of arbitrariness, which is a pre-determined factor.

Arbitrariness diminishes as a result of:

(a) the increase in the number of alternatives offered to the applicator;

(b) the decrease in the number of applicants vying for a change in their status;

(c) the reason for the origination of the definition being the granting of privileges rather than the imposition of duties.

(b) The Internal Factors

The internal factor which has a bearing on the degree of arbitrariness of the juristic quantitative definition is the number of alternatives available to the applicator in his decision as to the fit between the applicant and the definition.

Alternatives are variations of similar defineds, from which the applicator is expected to choose the ones to which the definition applies. When a definition restricts the applicator's decision to one variety of defineds only - for instance, the definition that only a firm which employs 50 persons can qualify as a small business, and not one which employs 49 or 51 - then the definition has offered the applicator only one alternative, which is tantamount to no alternative at all, as it means that the applicator has to decide that only a firm which employs 50 persons is a small business. Under no circumstances could he then decide that a firm

which employed 49 or 51 persons was also a small business.

In the quantitative definition these alternatives are decided by the numerical determinants which accompany the quantitative criteria. The number of alternatives offered by these numerical determinants can be correlated with the way in which they are incorporated within the definition.

There are three known formations according to which the numerical determinants may be incorporated within a juristic quantitative definition:

1. The single numerical determinant.
2. The double threshold determinant.
3. The upper threshold determinant.

The single numerical determinant is demonstrated by the following quantitative definition:

A small business is one which employs 50 persons.

This formation of the single numerical determinant is the most inflexible, and consequently also the most arbitrary of the three formations, because it offers no alternative or variation for the fixed numerical specification which acts simultaneously as an inclusion and exclusion barrier. Only enterprises with exactly 50 employees are included in the definition.

The double threshold determinant is exemplified in the following definition:

A small business is one which employs between 50 and 100 persons.

In this formation the number of the alternatives increases in direct relation to the increased numerical gap between the lower and the upper threshold determinants. The definition accepts 51 variations of the same defined: a business with 50 employees; a business with 51 employees; or with 52 employees; or with 53 employees - up to a business with 100 employees. In other words, the definition offers the applicator a choice of

51 ways of interpreting the definition. It is apparent that this formation is less arbitrary than the previous one, because it offers more alternatives.

The upper threshold determinant is the one used in the following quantitative definition:

A small business is one which employs a maximum of 50 employees.

This formation consistently offers one alternative less than the double threshold formation.[23] And although a reduction of one alternative out of a hundred is negligible, a reduction of one out of four might be meaningful. Therefore it might be concluded that the upper threshold formation is more arbitrary than the double threshold one, because it offers fewer alternatives.

This would have been a correct conclusion, had the degree of arbitrariness depended only on the number of alternatives offered by the definition. But as the degree of arbitrariness depends also on other factors, among which is the number of applicants wishing to be included in or excluded from the definition, it can and will be shown that the upper threshold formation is the least arbitrary of the three, despite the fact that technically it offers one alternative less than the double threshold formation.

(c) The External Factors

The external factor which has a bearing on the degree of arbitrariness of the juristic quantitative definition is the number of applicants who are dissatisfied with the status imposed on them by the definition, and who wish to alter it by either being excluded from, or included in it.

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23 The second formation offers 51 alternatives, being the numbers between 50 and 100 inclusive; whereas the third formation offers only 50 alternatives, being the numbers between 1 and 50 inclusive.

In order to be able to estimate the number of such dissatisfied applicants, and to be able to show that one type of definition formation is bound to create more dissatisfied applicants than another, it is necessary to accept the assumption that not all those who are included within a definition wish to be excluded from it, and that not all those excluded press to be included. Usually, it will be only those that exist in "close proximity" to the numerical threshold determinants, who might aspire to cross from one side of the threshold to another. Those who are further removed from the thresholds are normally content to stay where they are, as they accept the fact that they are within the definition's jurisdiction. Whether they were there wrongly or rightly in the first place is immaterial, for it must be accepted that arbitrariness is a subjective effect felt by those affected adversely by it, and not by those affected favourably or by those who are indifferent.

As to the range that would constitute "close proximity" to the threshold, this is to be decided independently, according to the merit of each definition. If it were agreed that in the case of a small business definition, "close proximity" would constitute a range of 10 employees on either side of the threshold, it would mean that each threshold zone would include 20 dissatisfied types of applicants, 10, each with 1 employee progressively less than the other, and 10, each with 1 employee progressively more.

In practical terms it means that the sector affected by arbitrariness, as a result of a small business definition with a double threshold determinant, such as **A small business is one which employs between 50 and 100 employees**, will be limited to the following ones: at the lower end, to 10 applicants, each with 1 employee progressively less than 50, who might wish to be included in the definition; and to 10, each with progressively more than 50 employees, who might wish to be excluded. At the upper end, it will affect those 10 with less than 100

employees and those 10 with more than 100 employees, - making a total of 40 affected applicants.

While the double threshold determinant creates 40 dissatisfied applicants, the definition which is based on an upper threshold, such as **A small business is one which employs up to 50 employees,** will create only 30 dissatisfied applicants. This is so because the definition with an upper threshold determinant, which seems to have only one threshold, has actually got two thresholds. The one which is apparent is the upper threshold, and the disguised one is the lower threshold. It is the number 1, which is not mentioned in the wording of the definition.

A rephrasing of the same definition would read: **A small business is one which employs from 1 to 50 employees.**

The upper threshold of such a definition, like any of the thresholds previously mentioned, would create 20 dissatisfied applicants; whereas the lower threshold would create only 10 dissatisfied applicants, being those who employed from 1 to 10 employees and who wanted to be excluded from the definition. This means that the disguised lower threshold is actually only half a threshold, as it prevents only those within the boundaries of the definition from leaving, but is not called upon to stop anyone from entering. This is so simply because you cannot have a negative number of employees. In practice, the same threshold can differentiate only between different numerical values of the same criterion, and the same polarisation, either positive or negative. What the disguised lower threshold is in effect doing is to differentiate between different criteria and different polarisations, in this case between a positive number of employees and a hypothetical negative number of employees. And because this is not the usual task allocated to a threshold, no reference is made to it, and it is therefore considered a disguised threshold.

Resulting from this is the fact that the definition with an upper threshold determinant creates a total of only 30 dissatisfied applicants; whereas the definition with the double threshold determinants creates 40 dissatisfied applicants. Consequently the former is the less arbitrary one.

This threshold approach is not applicable to the definition with a single numerical determinant such as, **A small business is one which employs 50 persons**, because the single numerical determinant includes only one defined, in the present case the one which employs 50 people. Had this single numerical value been allowed to be excluded, it would have resulted in a definedless definition. And whereas a defined can exist without a definition, a definition without a defined, although possible in theory, is impractical in reality, as it renders the definition useless. The external factor (being the number of dissatisfied applicants) is therefore used only for assessing the degree of arbitrariness of the "double" and the "upper" determinant formations, and not for the "single numerical determinant" formation.

The degree of arbitrariness of the three types of definition formation, judged according to its first two contributory factors, implies that:

1. The single numerical determinant is the most arbitrary, according to the internal factor, because it offers the fewest alternatives to the applicator. (And because the external factor does not apply to this formation, the conclusion from the internal factor prevails.)
2. The definition with the upper threshold is the second most arbitrary, according to the internal factor (as it offers 1 alternative less than the double threshold determinant), and the least

arbitrary according to the external factor, as it creates the fewest dissatisfied applicants (in this case 25% less than the double threshold determinant).

3. The definition with the double threshold determinant is considered the least arbitrary according to the internal factor (since it offers the most alternatives to the applicator), and the more arbitrary, according to the external factor, because of the two formations to which this factor applies, it creates more dissatisfied applicants than the upper threshold definition.

On balancing the degrees of arbitrariness attributed to each type of determinant by the different factors used to judge it, it seems that the "upper threshold determinant" is considered the least arbitrary, because according to one factor it was the least arbitrary, and according to the other it was the second most arbitrary; whereas the "double threshold determinant" was the most arbitrary according to one factor, and the least arbitrary according to the other.

Most quantitative definitions of small businesses belong to the upper threshold determinant formation, and therefore the arbitrariness which is built into the concept of the quantitative criteria is not of the extreme category.

(d) The Pre-Determined Factors

The third factor which determines the degrees of arbitrariness of a quantitative definition is whether its subject-matter is the imposition of duties, or the granting of privileges. These are further divided into four sub-groups:

1. The imposition of duties.
2. The exclusion from duties.
3. The granting of privileges.

4. The simultaneous granting of privileges to one defined, and the imposition of duties on another.

The degree of arbitrariness of the pre-determined factors is judged according to the number of alternatives which ensue from the subject matter of the definition. The internal factors dealt with the alternatives available to the applicator, the external factors dealt with the alternatives available to the applicant, and the pre-determined factors are concerned with the alternatives which are open to the defined.

The imposition of duties is the essence of the following definition:

All businesses with up to 50 employees will pay a £50 p.a. levy.

The reason for the formulation of the definition is the imposition of a duty, which is levied in a manner which deprives the defined of previously held alternatives, leaving him with none but the obligation to comply with the duty.

The exclusion from duties is expressed by the next definition:

All businesses with up to 50 employees will be exempt from the levy.

Although this definition is neutral, in the sense that it does not reduce or increase the defined's existing duties or privileges, it does in effect allow him two options:

a) to volunteer and join the included,

b) not to join the included.

This defined is therefore in a more advantageous position than the previous one, as he has two options, in comparison with the former's nil options.

The granting of privileges is expressed in the following definition:

All businesses with up to 50 employees will receive a grant of £50 p.a. per employee.

According to this definition the defined has two alternatives:

a) to refrain from collecting the grant,

b) to accept the grant.

The granting of privileges and the exclusion from duties, allow the identical number of two alternatives, and therefore the grant of a privilege is equal (in respect of arbitrariness) to an exemption from duty.

The simultaneous granting of privileges to one defined and imposition of duties on another is expressed in the following definition:

> **All businesses with up to 50 employees will receive a grant of £50 p.a. per employee and all businesses with more than 50 employees will pay a levy of £50 p.a. per employee.**

The definition distinguishes between two groups of defineds, the privileged vis-à-vis the encumbered. And while the privileged are offered three alternatives - being:

1. to use their privilege and collect the grant;
2. not to use their privilege, and not to collect the grant;
3. to join the encumbered group and pay the levy -

the encumbered defineds were allowed no alternative at all, and were expected to abide by the imposition of duty.

Since arbitrariness means the lack of alternatives, the more options offered to the defined, the less arbitrary is the definition. A definition which is a condition for the grant of privileges is less arbitrary than the one which imposes duties, as a privilege by its definition is a function subjected to a choice. Had this not been so, and the privileged had not been allowed to decide whether they wanted to be privileged or not, there would not have existed a difference in arbitrariness between a privilege and a duty. The grantor of a privilege is not expected to enforce it. He lets the grantee decide whether to take possession of it or not. However the imposer of a duty does not leave its fulfilment to the discretion of the dutiable, but guarantees its enforcement himself.

Arbitrariness is not synonymous with the numerical determinants

which accompany the quantitative criteria. Arbitrariness implies a lack of alternatives. It is therefore not a symptom exclusively of quantitative definitions, but is found in qualitative ones as well. The selection of specific qualitative criteria to define a defined is as arbitrary as its definition by quantitative criteria, because the mere selection of specific qualitative criteria as its definers, deprives it of the possibility of being defined by other criteria, whether qualitative or quantitative. Since there is no certainty that the qualitative criteria selected by the definer to define the defined are the only correct ones, it must be accepted that the qualitative definition also has arbitrary elements.

Here follow three examples of how the duty-imposing or privilege-granting subject-matter of a legislative act influences the degree of arbitrariness to which the defined is subjected.

1. The "Close Company" (UK)

The UK "close company" is an example where the subject matter, being the imposition of duties, leaves the defined with no options but to abide by the law.

A partial definition of a UK "close company" is that it is under the control of five or fewer persons, or of any number of shareholding directors.[24] The definition was formulated for the purpose of imposing extra duties on such companies, by which they were required to distribute a certain proportion of their annual income in the form of dividends.[25] Such an obligation is not demanded from other types of companies.

The analysis of the present definition discloses that as regards the threshold determinants, it has only an upper threshold, and therefore belongs to the least arbitrary formation, but as its subject-matter imposes

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24 Income and Corporation Taxes Act 1970, Sec.282(1).

25 Ibid., Sec.290.

duty, it belongs to the most arbitrary category. In cases where the subject-matter of the definition is the imposition of duties, its higher degree of arbitrariness nullifies the lower degree of arbitrariness which ensues from the structural formation of the definition.

In the case of the "close company", the defineds are deprived of any alternative, but have to comply with the duties imposed on them, which means that those that qualify have to distribute their profits in the prescribed manner.

2. **The Sex Discrimination Act 1975** (UK)

This Act is cited in order to demonstrate that when a definition has been originated for the purpose of excluding the defined from duties, it is less arbitrary than if it aimed at imposing duties, irrespective of its technical formation, which in the present definition is the upper threshold determinant.

The Act exempts employers who employ not more than five persons from compliance.[26] This means that the defined, namely the employer, has two options: to use this exemption and ignore the Act's requirements, or to forsake it and adhere to the Act. The fact that the defined has a choice indicates that the arbitrariness which accompanies a quantitative definition that exempts from duties is of a lesser degree than the one that imposes duties, as seen in the definition of the "close company".

3. **The Small Business Act 1953**(USA)

This legislation is introduced as an example of a definition which was originated for the sake of granting privileges to the defineds. The number of two alternatives attached to the "grant of privileges" is identical with those attached to the "exclusion from duties".

The declared purpose of this Act is to help and assist small

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26 The Sex Discrimination Act 1975, Sec.6(3).

businesses, by granting them an assortment of privileges.[27] The qualification for such benefits depends on compliance with the Act's definition of small business, which is composed of qualitative[28] and quantitative criteria. The latter are expressed by the "size standards", which are regulations that state the upper threshold determinants of the different criteria used.

Small businesses which comply with the conditions of the definition have two alternatives, either to avail themselves of the assistance, or to ignore it. Definitions that grant privileges are similar to definitions that exempt from duties, in that both offer the defineds two alternatives.

Examples of legislation where in the same legislative act the defineds are granted privileges while duties are imposed on others, are unavailable, owing to the realities of the legislative process. There are three reasons for this

1. Most legislation imposes duties, as this is its historically allocated task.
2. The grant of privileges, being rarer than the imposition of duties, is done by specific legislation which defines the defined by means of the positive method of definition.
3. The grant of privileges to one defined does not necessarily have to incur duties on another.

The result is that the legislator finds it more practical to deal with the granting of privileges and the imposition of duties separately, hence the unavailability of such legislative examples.

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27 Loans, assistance in procurement of Government contracts, and management assistance.

28 The Small Business Act 1953, Sec.3.

(v) Quantitative Elements in the US Definition of Small Business

The assertion that quantitative criteria ought to supplement the qualitative ones, if a workable definition of small business is to be formulated, is reinforced by the examples of the small business definitions adopted by the US **Selective Service Act**[29] and **Small Business Act.**[30] The former used the upper limit of 500 employees as a qualifying determinant, in addition to two qualitative criteria, while the latter relied on several quantitative criteria, of which employment and sales volume are the most frequently used. Other criteria, such as number of beds,[31] electrical output,[32] assets,[33] net worth,[34] average net income,[35] and ground area,[36] are used on few occasions only.

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29 1948.

30 As per Small Business Act 1953, Sec.3.

31 Sec.121 3-10(d)(5) of The Small Business Size Standard of the CFR: "...as small if it is primarily engaged in owning and operating a hospital and its capacity does not exceed 150 beds".

32 Sec.121 3-10(d)(11) of the Small Business Size Standard of the CFR: "...as small if, including its affiliates, it is primarily engaged in the generation, transmission and/or distribution of electric energy for sale and its total electric output for the preceding fiscal year did not exceed 4 million megawatt hours".

33 The criterion of assets is used by sec.121 3-10(e)(1)(i) of the Small Business Size Standard of the CFR in regard to the definition of small shopping centres: "...it does not have assets exceeding $8 million", and by sec.121 3-11(a), which specifies $9 million assets as an upper limit for small business.

34 Ibid., Sec.121 3-10(e)(1)(ii), "...it does not have net worth in excess of $4 million", and Sec.121 3-11(a).

35 Ibid., Sec.121 3-10(e)(1)(iii), "...it does not have an average net income, after Federal income taxes, for the preceding two fiscal years in excess of $400,000", and Sec.121 3-11(a).

36 Ibid., Sec.121 3.10(e)(1)(iv), "...it does not lease more than 25 percent of the gross leasable area to concerns which do not meet the small business definition contained in this section".

The reasons for the choice of a particular quantitative criterion and its numerical determinants are neither clear nor convincing. They depend on three underlying assumptions:

1. that each industry has its own best definitive criterion;
2. that within that criterion each industry has a special numerical upper limit, which distinguishes the small businesses from the big ones;
3. that the definer, that is, the administrative legislator, is in possession of that knowledge.

(vi) Quantitative Elements in The People's Republic of China Definition of Small Business

Until the recent publication of a qualitative definition of small business[37] in the **Beijing Review**, it could have been surmised with confidence that the People's Republic of China had no legal, nor juristic nor official definition of small businesses. Still, the **Beijing Review** definition is not an operational definition, but rather an ideological one, because it is based on qualitative criteria only.

For a quantitative definition of small businesses, it is necessary to refer to a speech delivered by Mao Tsetung[38] regarding the mechanisation of the handicraft industry, where the productivity was 30 times lower than that in the mechanised industries. And though he did not define a small business, the statistical data of "annual output per capita", which he introduced in his speech as proof of the urgency in improving the productivity of the handicraft industries, have served the author as a basis

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37 The definition appeared in "Collective Ownership Bright Prospects", Beijing Review, No.28, July 13, 1979, p.4.

38 Mao Tsetung, "Speed Up the Socialist Transformation of Handicrafts" (part of instructions by Mao Tsetung when the departments concerned reported to the State council their work on handicrafts), March 5, 1956. Selected Works of Mao Tsetung, Vol.V, Foreign Language Press, Beijing, 1977, p.282.

for assessing the size norm of a small business in the People's Republic of China.

The figures for "annual output per capita" - which is another name for a productivity criterion - quoted by Mao Tsetung are as follows:

1. "20,000-30,000 yuan in modernised State industry;"
2. "5000 yuan in mechanised and semi-mechanised co-operatives;"
3. "2000 yuan in big co-operatives with more than 100 handicraft men;"
4. "1500 yuan in small co-operatives;"
5. "800-900 yuan among independent handicraft men."[39]

The conclusions to be derived from them are these:

1. The main classification of industry in the People's Republic of China, which is made according to a productivity criterion, consists of five groups.
2. A secondary categorisation divides the industry into small and big enterprises, according to an employment criterion in which the determining threshold is the number of 100 employees.
3. Small enterprises consist of small co-operatives with less than 100 workers, and self-employed persons.
4. The "big" sector is sub-divided into three groups, of which only the smallest size is defined by an employment criterion, i.e. "big co-operatives of over 100 workers", while the distinction between the second and third categories is made by a "capital investment" criterion (mechanisation and semi-mechanisation), and one of "structure" (State-owned vis-à-vis co-operative).

A translation of Mao Tsetung's economic statements into a numerical format shows the overall economic structure of the People's Republic of China in 1956, and the position of small business within it.

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39 Since 1956 the rate of inflation in the People's Republic of China has been minimal.

People's Republic of China 1956: Industrial Size Structure

	Category	No. Employed	Value output (sales) yuan	Productivity	Criteria used to define each category
BIG	1	1000–1500	20,000,000–45,000,000	20,000–30,000	a. capital investment b. structure = State
BIG	2	250	1,250,000	5000	a. capital investment b. structure = co-operative
BIG	3	100	200,000	2000	a. employment b. structure = co-operative
SMALL	4	75	112,500	1500	a. employment b. structure = co-operative
SMALL	5	1	800–900	800–900	a. employment b. structure=self-employed

This statistical analysis indicates that a small business in the People's Republic of China has an upper limit of 100 workers and includes co-operatives and self-employed.

The criterion of productivity, chosen by Mao Tsetung to define the different industrial categories, is an example of how, by indicating the direction that the economy should follow, the quantitative definition acts as an administrative tool. The choice of the productivity criterion was significant to the economic aims of the People's Republic of China, which in 1956 was more concerned with productivity than with employment. These days when unemployment is admitted to exist, and its effects felt, it is likely that a small business definition would use an employment criterion instead.

(vii) Quantitative Elements in the UK Definition of Small Business

The UK official definition of small business is accepted to be the one suggested by the Bolton Committee. It is not a juristic definition, because it has not been adopted by any legislation, neither is it an administrative one, as it was not formulated by an administrative organ,

but by an independent Committee authorised by the Board of Trade[40] to inquire into the state of small businesses. Though the Committee's recommendations have not been officially accepted, a definition with a similar quantitative determinant to the one suggested by the Committee has been used as the qualification requirement for the Small Firms Employment Subsidy,[41] which defines small business as follows:

> "A firm may be able to receive SFES if it can show that it meets all the following conditions:
>
> it is a business in the private sector which is engaged in manufacturing activities;
>
> the total number employed by the firm (and by any subsidiary concerns) in Great Britain and elsewhere on 9 November, was less than 200;
>
> it is an independent business, that is not a subsidiary of another concern (whether that concern is in the public or private sector); except that a firm which is a subsidiary of another private sector concern may be eligible if total employment in both and any other subisidiary concerns was less than 200 on 9 November 1978."

The influence of the Bolton Committee's definition is recognisable in the upper threshold numerical of 200 employees and the "independence of the business", but the qualitative criteria of owner/manager and "personalised" management are missing.

The Bolton definition, whose qualitative criteria have been enumerated previously,[42] does not rely only on the latter, but combines them with quantitative criteria.[43] The definition uses three quantiative criteria - number of employees, turnover and number of vehicles. Manufacturing

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40 The Rt. Hon. Anthony Crosland, then President of the Board of Trade, appointed the Committee on July 23, 1969.

41 This definition appeared in a Department of Employment pamphlet headed: For Manufacturing Firms in Great Britain, Small Firms Employment Subsidy. Prepared by the Department of Employment and the Central Office of Information, Dd 597053 p.20, 11931, 150M 12/78 pl 622.

42 See Ch.7(i), pp.141-145.

43 The USA and the People's Republic of China have also combined quantitative and qualitative criteria in definitions of the small business.

enterprises, construction and mining were defined by the employment criterion;[44] retailing, wholesaling, the motor trades and miscellaneous enterprises were defined by a turnover criterion;[45] and enterprises in the road-transport field according to their number of vehicles.

The employment criterion used two numerical determinants: for the manufacturing industries an upper threshold of 200 employees; and for construction and mining 25. The Committee explained the choice of this criterion on account of its being more accurate than net output or the number of firms,[46] and the choice of the 200-employee threshold because most enterprises with this number of employees conformed to the qualitative requirements of small business.

This could have sounded a genuine reason, had not the continuation of the same sentence read as follows: "... but so also do many manufacturing firms employing 500 or even more..."[47] This is an admission that the determinant of 200 employees cannot be correlated with the qualitative attributes of small business, and is therefore an arbitrary number. Whether the upper limit of 25 employees for the mining and construction industries was decided upon in a similar manner has not been divulged by the Committee, which excused its lack of rationale in the choice of quantitative criteria, in the following words:

> "We recognise that no single quantifiable definition can ever be entirely satisfactory."[48]

With that self-justification - the unattainability of an ideal criterion - the Committee felt absolved and free to choose any criterion and

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44 The US Small Business Act 1953 used the same criteria for the definition of the same industrial sectors.

45 The same Act (Ibid.) treated these sectors similarly.

46 J.E. Bolton, Small Firms. Report of the Committee of Inquiry on Small Firms, HMSO, Cmnd.4811, 1971, p.34, par.3.18.

47 Ibid., p.2, par.1.8.

48. Ibid.

any numerical determinant, as it admitted in so many words:

> "... and a series of more or less arbitrary definitions in terms of whatever measures appear appropriate for other trades".[49]

Concerning the reasons which prompted the selection of the turnover criterion, as a determinant for four industrial sectors out of the nine mentioned, or of the criterion of five vehicles for the road transport sector, the committee did not volunteer any explanation, apart from the sweeping admission that it was an arbitrary choice.[50] The numerical upper thresholds of turnover were fixed as follows: wholesale trade at £200,000 p.a.; retailing at £50,000 p.a.; the motor trade at £100,000 p.a.; and miscellaneous at £50,000 p.a.[51] These figures have not been officially revised since their publication in 1971. When they were referred to in 1976, by a report of the Commission of European Communities,[52] they had to be raised by 50% to account for inflation.[53]

(viii) Quantitative Elements in the Israeli Definition of Small Business

The official Israeli small business definition, as used by the Ministry of Commerce and Industry, and the Small Industry Advisory Centre, for the purpose of statistical data, is that of an enterprise employing up to 50 employees.[54] The upper limit of 50 employees is

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49 Ibid., p.2, par.1.9.

50 Ibid.

51 Ibid., p.3, table 1.I.

52 Definitions of Small and Medium Sized Enterprises and the Artisanat. Commission of the European Communities, 413/III/76FE Orig. F April 1976, p.16.

53 The 50% increase was based on 1974 figures.

54 (a) A Compilation of Statistical Data Relating to Small Industry during the Period 1965-1975. The Small Industry Advisory Centre in co-operation with the Productivity Institute, March 1977.

(b) A later compilation of statistical data relating to 1975-1977 was obtained from the Small Industry Advisory Centre prior to publication (in Hebrew).

explained as a turning point in productivity, according to research carried out in Israel.[55]

Three observations emerge from the study of the Israeli definition:

1. It is based exclusively on a quantitative criterion. This differentiates it from the other definitions studied hitherto, where the quantitative criteria were supported by qualitative ones.
2. It uses one criterion only, that of employment, whereas the USA and UK definitions relied on several quantitative criteria.
3. It uses only one numerical determinant for all the economic sectors, whereas in the USA and the UK different upper limits of the employment criterion were used for various industries.

Conclusion

This survey of quantitative elements in the small business definitions of the four compared countries indicates that:

1. In three out of the four (USA, People's Republic of China and UK) quantitative elements were combined with qualitative ones.
2. That two out of the four (USA and UK) used more than one quantitative criterion, applying different ones to different industries.
3. That three out of the four (UK, USA and Israel) used the employment criterion; two (UK and USA) used the turnover criterion; and one (People's Republic of China) used a productivity criterion.

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55 S. Dombrovsky, "The Potential of the Israeli SmallIndustry in a Macro-Economic Context", Report (in Hebrew) submitted to the Israeli Institute of Productivity, June 1976, p.1.

Prima facie, the combined use of qualitative and quantitative criteria should be the ideal, since one type should complement the other and thus offer a comprehensive definition of small businesses.

However, when the effect of the combination on quantitative definitions is taken into account, it is seen to be counter-productive, as it cancels these definitions' advantages and sustains their disadvantages. The definition loses clarity, directiveness and adaptability, but retains its ambiguity and inflexibility. Consequently the joint, qualitative-cum-quantitative definition is an inferior product to the exclusively quantitative one.

PART THREE

PRACTICE

CHAPTER TWELVE

THE EMPLOYMENT CRITERION IN THE LEGISLATION OF THE USA, THE PEOPLE'S REPUBLIC OF CHINA, THE UK AND ISRAEL

Introduction

The study of legislation relating to the definition of small business, reveals a consistent pattern; the use of quantitative criteria, specified by numerical determinants. Whichever legal system is examined, or whatever the criterion used, or the subject-matter of the law, each definition of small business hinges on a numerical determinant. As a result, the study of how legislation has defined small business simplifies itself into a study of the numerical specifications used in its definition.

As to the reasons which prompted the legislators' choice of quantitative criteria in general, and their numerical determinants in particular, two explanations are offered. The first deals with the concept itself, and the second with its practical aspects. The legislators, in common with the Equilibristic Decision-Making System (EDMS), have recognised the secondary status of the small business as a phenomenon, and have accordingly allocated quantitative criteria to its definition. As to the practical aspect, it is recognised that for legislation to be effective, it must be capable of enforcement, and definitions must be easily employed by the applicators and understood by the applicants. For the fulfilment of these tasks, no other measures are as suitable as the numerical determinants that accompany all quantitative criteria. Be it employment or turnover, shareholding or assets, they are all quantifiable with an upper or lower numerical threshold.

The employment criterion which has been the most popular in the definition of small business, is used by two definition methods, the positive and the exclusive. The positive method of definition is

used only on the few occasions when the legislator has set out to define small businesses per se, while the exclusive method of definition, which uses the employment criterion for the purpose of excluding the defined from duties, is the one most often used. The employment criterion is found mainly in labour-related legislation, which is in keeping with the tendency of the criteria used by a definition to relate to its theme. These labour-related legislative acts define small businesses primarily in order to exempt them from compliance with labour regulations. The sizes of the exempted businesses are particularly small, because it would not have been in the legislators' interests to widen the exempted sector. This legislative pattern has been followed by all four researched countries.

(i) The Employment Criterion in the Legislation of the USA

Diverse and unrelated US legal regulations have used the employment criterion in order to differentiate the size of a business or an establishment, and/or to ascertain the existence of a "situation". An employment criterion has defined: a business in the **Selective Service Act 1948**[1] and the **Small Business Size Standards** regulations[2] (as authorised by the **Small Business Act 1953**[3]); an establishment in the

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1 PL 759, 80th Congress, Sec. 18(a).

2 13 CFR part 121, Small Business Size Standards,
Secs. 121.3-8 p.250; 121.3-8(b)(1) p.251;
121.3-8(b)(3) p.251; 121.3-8(b)(7) p.252.
121.3-8(c)(1) p.252; 121.3-8(d)(2) p.253;
121.3-8(f)(1) p.254; 121.3-8(f)(2) p.254;
121.3-8(g)(1)(i) p.254; 121.3-8(g)(2) p.255;
121.3-9(a)(1) p.255; 121.3-10(b)(2) p.257;
121.3-10(b)(3) p.257; 121.3-10(f)(2) p.258;
121.3-12(b) p.259.

3 Small Business Act 1953, PL 85-536, Sec.5(b)6, 73 stat 385.

Fair Labor Standards Act 1938,[4] and a "situation" in the **Regulations for Certification and Adjustment Assistance for Firms and Communities**[5] (as authorised by the **Trade Act 1974**).[6] The grouping of businesses and establishments according to their number of working or affected employees was undertaken by the legislator in order to single out the enterprises that were entitled to Governmental concessions and/or exemptions.

The legislative acts that have granted aid to small businesses on the basis of their small number of employees are both numerous and diverse. The **Small Business Size Standards** regulations[7] offered small businesses the following assistance programmes: Government procurement,[8] sales of Government property,[9] Small Business Administration (SBA) loans,[10] investment assistance,[11] Government subcontraction,[12] lease guarantee,[13] prospecting and mining rights,[14] surety and bond guarantee,[15] and pollution control guarantee assistance.[16]

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4 Fair Labor Standards Act 1938, Section 13(b)(14).

5 13 CFR 315 Sec.315.28(b)(1) p.448; Sec.315.98(a)(1)(i) p.459.

6 PL 93-618, 88 stat. 1978. 19 USC 2101 et seq.

7 13 CFR Part 121 p.237.

8 Ibid., Sec.121.3-8.

9 Ibid., Sec.121.3-9.

10 Ibid., Sec.121.3-10.

11 Ibid., Sec.121.3-11.

12 Ibid., Sec.121.3-12.

13 Ibid., Sec.121.3-13.

14 Ibid., Sec.121.3-14.

15 Ibid., Sec.121.3-15.

16 Ibid., Sec.121.3-16 (under PL 94-305).

The **Trade Act 1974**[17] introduced assistance for a "situation" of unemployment, to small firms that had to make workers redundant; and the **Fair Labor Standards Act 1938**[18] exempted small businesses from overtime pay rates. The regulations of the **Communications Act 1934**[19] relieved small employers from the duty to submit an Equal Employment Opportunity programme, while the **Occupational Health and Safety Regulations**[20] waived certain reporting requirements, and the **Environmental Protection** regulations were modified for them by the Environmental Protection Agency (EPA).[21]

In all the hitherto mentioned legislations, the employment criterion has been used for the purpose of determining the "size" of a business, an establishment or a situation, which, in itself, is not an automatic indication that the defined's size is "small", let alone that the defined is a small business. In order to decide whether the use of the employment criterion constitutes a small business definition, it is necessary to examine its usage in the context of each specific legislation, and correlate it with the legislator's declared or ascertained aims.

The mentioned legislations can be divided into three categories according to their use of the employment criterion; the "non-business" definition, the positive definition, and the definition by exemption.

(a) Non-Business Definitions

By "non-business" definitions are meant definitions that use

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17 Supra, note 6, p. 225.

18 Sec.13(b)(14) of the Act.

19 47 CFR Part 73, Radio Broadcast Services, Sub-part A. Sec.73 125 (c) p.79.
Sub-part B Sec.73.301 (c) p.204. Sub-part E Sec.73.680 (c) p.323.
Part 76, Cable Television System, Sec.76.311(c)(i)(b) p.559.
Part 23, International Fixed Public Radio Communication Services, Sec.-23.55(c)(i)(b).

20 29 CFR Sec.1904.15, p.42.

21 40 CFR Sec.413.61(b), p.205.

criteria such as employment, which are usually associated with business, yet define enterprises or institutions such as the police or the fire brigade that are removed from the world of business. The **Fair Labor Standards Act 1938** referred to such organizations while using the employment criterion to qualify their size. Other "non-business" definitions are those which, though they refer to business and use criteria and determinants[22] that are related to small business, define a "situation" and not a business enterprise. Such a definition is found in the **Trade Act 1974** regulations.

(a.1) The Trade Act 1974 - Regulations

The regulations pursuant to Section 251(c) of the **Trade Act 1974** exemplify the use of the employment criterion by a "non-business" definition. Sections 315.28[23] and 315.98[24] of the **Regulations for Certification and Adjustment Assistance for Firms and Communities**[25] use the lower limits of 50 and 200 employees respectively, as the definition for a firm's or a community's eligibility for adjustment assistance. This definition has been classified as a "non-business" definition for the following reasons:

1. The regulations deal with a state of imminent redundancies in concerns and communities, which is a "situation" and not a business.
2. The numbers of 50 and 200 employees constitute the lower limit

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22 Low numerical determinants of employment, turnover, assets and payroll, to mention but a few criteria, are associated with small business.

23 13 CFR 315.28, p.448.

24 Ibid., p.459.

25 Ibid., Part 315, p.442.

of the definition and not its upper limit,[26] which means that the eligibility for adjustment assistance is created by a minimum figure and not a maximum one, inferring that the maximum could be any higher number than 50 or 200 redundant employees. As a large number of employees is by its nature incompatible with a small business, this definition cannot serve as a small business definition.

3. The employees in question are not able to constitute an organisation, since they are not functioning employees, but redundant or about to be redundant - "totally or partially separated",[27] and as such they form part of a "situation" (of unemployment) and not of an organisation.

4. The legislator's aim is to prevent redundancies, i.e. "separation", in order to maintain a high level of employment, not just in small businesses, but also in big ones. Its purpose is therefore to aid the whole economy and not just a specific sector within it.

5. The adjustment assistance is not exclusive to businesses, but is extended to "communities",[28] which are larger demographic units than firms, and whose eligibility for assistance was therefore determined by the larger number of 200 unemployed, instead of the lower figure of 50 unemployed, which was reserved for firms.

6. The fact that the same criterion was used to define a "situation" which prevails in an industrial concern and a social community indicates that the legislator was concerned more with the effects unemployment had on the employees than its effects on the businesses.

The regulations have used an **unemployment** criterion, rather than an **employment** one, to define those eligible for Government assistance.

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26 13 CFR Sec.315.28(b)(1), p.448.

27 13 CFR Sec.315.28(a)(1).

28 13 CFR Sec.315.98.

Although both criteria, "employment" and "unemployment", are based on numbers of employees, the one deals with active and functioning employees who are the basis of an enterprise,-the "employed"; whereas the other is concerned with ex-employees, who create a "situation" and not an organisation,-the "unemployed". Thus it can be seen that in this case the employment criterion was designed to describe a "situation", and not a business, and therefore it cannot serve as a small business definition.

(b) Positive Definitions of Small Business

In the category of positive definitions of small businesses are included legislations that declare their intention to define a small business and use the employment criterion as a sole or partial component of the definition. Examples of such legislations in the USA are the **Selective Service Act 1948** and the **Small Business Act 1953** and the pursuant **Small Business Size Standards** regulations.

(b.1) The Selective Service Act 1948[29]

The small business definition of the **Selective Service Act 1948** belongs to the category of positive definitions. It consists of three interdependent criteria, of which employment with an upper threshold of 500 employees is one. The Act's use of the employment criterion is unique, in that it is the only prime legislation that employs it in a quantitative and not just a qualitative manner.

As mentioned,[30] the Act originally defined small businesses in order to enable them to benefit from the Government's "war effort" contracts. This restricted application, coupled with the fact that the employment criterion was only one of the definition's three conditions, precluded the Act's small business definition from serving as a unitary definition of small businesses; though in itself, the determinant of 500 employees might be an appropriate criterion if there were reasons to believe that it

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29 Supra, note 1, p.224.

30 See p. 95.

reflected the true size of small businesses.

(b.2) The Small Business Act 1953

The employment criterion is not mentioned as a condition by the small business definition of the **Small Business Act 1953**, but has been introduced by the **Small Business Size Standards** regulations which the Act authorized:

> "In addition to the foregoing criteria, the Administrator, in making a detailed definition may use these criteria, among others: Number of employees and dollar volume of business."[31]

The **Small Business Act 1953** was included within the category of the positive definitions of small businesses because it states its intention to define a small business, "... for the purpose of this Act, a small business concern shall be deemed to be one that ..." The definition it uses is considered the most important small business definition in US legislation, and has been used not only for the Act's own requirements, but has been adopted by other legislative instruments that affect the small business sector.

Legislative acts that adopted the **Small Business Act** definition are the following:

1. The **Trade Act 1974** (Regulations)[32]
2. The **Small Business Investment Act 1958**
3. The **Federal Water Pollution Control Act** (Regulations)[33]
4. The **Housing and Urban Development Act 1968** (Regulations)[34]

(b.2)a. Number of employees as per the Small Business Act – Regulations

The actual number of employees which determines small business status in accordance with the **Small Business Act** and its pursuant

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31 Small Business Act 1953 (as amended), Sec.3.

32 13 CFR Sec.315.58, p.453.

33 Amendments of 1972, 33, USC 1151 et seq. 42 FR 8083, Feb. 8, 1977, 40 CFR Sec.21.1; 21.2a.

34 12 USC 1701a. 24 CFR Part 135 Sec.135.5(b).

Small Business Size Standards regulations varies from industry to industry, and within it as well. An "industry" is classified as a sub-division of a major group. For example, the food industry is major group No. 20 and is sub-divided into 28[35] sub-groups (with a census classification code attached to each), each specifying a specific number of employees that qualifies it for a small business certification. For instance meat packing plants have an upper limit of 500 employees, whereas canned specialities allow 1000 employees, and wet corn milling 750 employees. Out of the 28 sub-groups of the food industry, 19 have an upper limit of 500 employees, 6 a limit of 750 employees, and 3 a limit of 1000 employees.

In contrast to the food industry, the petroleum refining and related products industry, classified as major group No.29, has only 3 sub-divisions. Petroleum refining was allotted 1500 employees, asphalt felt and coating 750 employees, and lubricating oils and greases 500 employees.[36]

Similar size standards are attached to each industrial sub-division of the economy, by Schedules A and F of the **Small Business Size Standards**, and are used for determining the status of applicants from the manufacturing sector, who apply for business loans, displaced business loans, economic opportunity loans, surety bond guarantee assistance, and small business investment company (SBIC) assistance. For other assistance programmes, which are offered by the Small Business Administation (SBA) such as Government procurement, different upper limits of employees have been adopted.

(b.2)b. Number of employees as per Government procurement programme

Government procurement assistance is a programme offered by the

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35 Schedule A, Employment Size Standards For Concerns Primarily Engaged in Manufacturing, Rev. 13.39 FR 44424. Dec. 24, 1974, as amended by Amdt. 6, 40 FR 50519. Oct. 30, 1975.

36 Ibid.

Small Business Administration to give small business a share in Government contracts. This programme has promulgated its own definition of small businesses:

> "a concern bidding on a Government contract is a small business if, including its affiliates, it is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts, and has 500 employees or less."[37]

From this definition it might seem that the size norm for the Government procurement programme is 500 employees; but this is misleading because, according to Schedule B, approximately a third of the industries involved do not conform to this norm.[38]

The disparity between the maximum number of employees needed to qualify as a small business for the Government procurement programme, and other Small Business Administration assistance programmes, means that the same business may be considered small by one programme and large by another. For example, the textile and mill products industry, major group No.22, sub-group 2261, can employ up to a maximum of 1000 employees, and be still considered as a small business for Government procurement purposes. However, for Small Business Administration loans, displaced loans, economic opportunity loans, surety bond guarantee assistance, and small business investment company assistance, the same sub-group, 2261, would not be allowed to have more than 500 employees, if it wished to be certified as a small business. The same applies to sub-group 2911, petroleum refining, which for the purpose of the Government procurement programme was assigned an upper limit of 500 employees, and for other Small Business Administration programmes, an upper limit of 1500 employees.

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37 Supra, note 8, p.225.

38 Rev. 13 39 FR 44424. Dec. 1974, as amended by Amdt 8. 41 FR 4013 January 28, 1976. Part 121 SBA Rules and Regulations Schedule B.

(b.2)c. Number of employees as per sale of Government property

For the purpose of sale of Government property,[39] a small business is (among other qualifications) one whose number of employees does not exceed 500 persons. There are, however, two exceptions: the first is the petroleum refining industry, in which an enterprise that employs as many as 1500 employees[40] is considered to be small; and the second regards the sale of special salvage timber, for which a small business is one with the unusually low figure of 25 employees.[41]

The first exception is attached to a specific industry, whereas the second is attached to a specific item of sale and is applicable to any industry dealing in such an item, regardless of any other requirements imposed on the firm by other legislations.

(b.2)d. Number of employees as per Small Business Administration loans

For the purpose of Small Business Administration loans,[42] industries were divided into two: those mentioned in Schedule A of the Small Business Regulations, which had to abide by the employment determinant of the Schedule; and those not mentioned by Schedule A, which were allotted a standard upper threshold of 250 employees.[43]

(b.2)e. Number of employees as per Government sub-contractors and mining leasing

For the purpose of Government sub-contractors, a small business concern is one whose number of employees does not exceed 500

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39 Supra, note 9, p. 225.

40 13 CFR Sec.121.3-9(a)(1).

41 Ibid., Sec.121.3-9(c)(iv) as amended - 25.44 FR 34 Jan. 2, 1979.

42 Supra, note 10, p. 225.

43 13 CFR Sec.121.3-10(b)(2). Amendment 26 44 FR 1725, Jan. 8, 1979.

persons,[44] including all its affiliates. And for the purpose of Government leases of uranium prospecting or mining rights, a small business is one that employs not more than 100 persons.[45]

(b.2)f. The inconsistency of the employment determinants

When the **Small Business Act 1953** instructed the Administrator to add quantitative criteria (employment being one of them) to the three qualitative ones, it specified that the number of employees constituting a small business should be determined in the context of the smallness of each individual industry. Though this method of determining the size of a business was meant to assist small businesses by establishing them as a competitive factor within each industry, it resulted in too many size standards - which both complicates their existence and leaves the question of what constitutes a small business unanswered.

A definition with a few exceptions can still be a practical proposition. However, the many different size standards of the Small Business Administration's regulations have rendered the small business definition complicated and cumbersome: the exemptions obscure the rule.

(b.2)g. Method of establishing the employment size standards

The **Small Business Act** and its pursuant regulations have equipped the administrator with a detailed procedure with which to establish the appropriate number of employees that constitutes a small business in each industrial sub-group classification.[46]

The administrator seeking to determine the correct number of

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44 13 CFR Sec.121.3-12(a), Rev.13 Amdt.9, 41 FR 5124. Feb. 4, 1976.

45 13 CFR Sec.121.3-14. Rev.13 40 FR 4119, Jan. 28, 1975.

46 13 CFR Sec.121.3-1 p.238.

employees will first consult the Industrial Classification Manual.[47] If this does not produce an immediately satisfactory decision, he will enlist the aid of the Assistant Administrator for Advocacy, Planning and Research, whose task is to develop and recommend small business size standards, to conduct industry hearings pertaining to size matters and, in concert with the Office of the General Council, to issue interpretations of the **Small Business Size Standards** regulations. The Assistant Administrator also considers and takes appropriate action regarding petitions which object to, or request amendments to or withdrawal of publicised standards.[48] A further resource is the industry group concerned, which is permitted to voice its disagreement with the established or proposed size standard at oversight hearings, in which representatives from the industry submit their arguments regarding the acceptance or rejection of a proposed size standard.[49]

(b.2)h. High number of employees in recession areas

The number of employees constituting a small business differ not only from industry to industry, and within each industry, but also in the same sub-industrial division, according to its geographical location.

For specific assistance programmes, such as the Financial Assistance Program of the Small Business Administration, and the Financial Assistance of the **Small Business Investment Act 1958**, an increase of 25% in the number of employees is allowed to a business which operates within an area of substantial unemployment, underdevelopment or redevelopment.[50]

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47 The Standard Industrial Classification (SIC) is prepared and published by the Office of Management & Budget, Executive Office of the President.

48 13 CFR Sec.121.3-3.

49 Hearing of the Select Committee on Small Businesses to the US Senate, and Procurement Assistance Program of the Small Business Administration, Washington DC Nov. 11, 12 and 13, 1975.

50 13 CFR Sec.121.3-7(1), p.249.

(b.2)i. Number of employees per concern

Although the maximum number of employees qualifying for a concern's small business definition varies with each industrial sub-division, and in each programme, the method of calculating their actual number is uniform to all the industries and programmes.

As a general rule, the "number of employees" is defined as:

> "... the average employment of any concern, including the employees of its domestic and foreign affiliates, based on the number of persons employed on a full-time, part-time, temporary or any other basis during each of the pay periods of the preceding 12 months."[51]

When the yearly average of the employees exceeds the permitted maximum, but the employment level of the last yearly quarter is at least 25% lower than in the corresponding quarter of the preceding year, owing to the shortage of energy, or materials, or as a result of a major economic recession, then, for the purpose of size determination, the number of employees is determined by reducing the yearly average employment by the determined percentile.[52] A new business which cannot supply a year's performance records is allowed to calculate the number of its employees on the average period of its existence.[53]

A concern that has acquired an affiliate during the relevant period of accounting must include also the affiliate's number of employees before the purchase in the yearly average calculations.[54]

Once the number of employees has been determined, the Small Business Administration issues a size determination in writing, stating that a concern is, or is not, or was, or was not, a small business within the

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51 13 CFR Sec.121.3-2(t), p.244 (Rev.13 Amdt.16 42 FR 35855 July 12, 1977).

52 Ibid.

53 13 CFR Sec.121.3-2(t).

54 Ibid.

meaning of the Act.[55] The size determinations are issued by the Regional Director or his delegates,[56] except for lease reinsurance purposes, where the size determination would be undertaken by the Associate Administrator for Finance and Investment.[57]

The size determination has to be notified in writing, by registered post (certified mail), to the concern affected, and it becomes effective immediately, until and unless it is reversed by the Small Business Size Appeals Board.[58] The size determination has to be based preferably on documented facts supplied by the parties requesting the affirmation or its annulment.[59]

A rejection of an application for a small business status by the Small Business Administration prevents a concern from receiving any assistance under the **Small Business Act** or the **Small Business Investment Act 1958**, unless it is recertified as a small business.[60] After a loss of small status the concern cannot self-certify itself as small by lowering its number of employees or its turnover, or by including itself within an industrial sub-division with different qualification requirements. The concern has to apply for recertification, showing significant changes in its ownership, management, contractual relations, or other factors influencing its status as a small business.[61]

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55 13 CFR Sec.121.3-2(y).

56 13 CFR Sec.121.3-4(a). (Rev.13 Amdt.19, 43 FR 13498 Mar. 31, 1978).

57 Ibid.

58 Ibid.

59 13 CFR Sec.121.3-4(c). (Rev.13 Amdt.19, 43 FR 13498 Mar. 31, 1978).

60 13 CFR Sec.121.3-4(d). (Rev.13 Amdt.19, 43 FR 13498, Mar. 31, 1978).

61 Ibid.

(b.2)j. Protesting against a small business status

In cases where a business is bidding for a particular Government procurement or Sale, where its small business status can be of an advantage, any other bidder or offerer or other interested party can challenge the small business status of a concern.[62] The protest has to be delivered in writing, by hand, telegram or mail, to the contracting officer responsible for that particular procurement or sale, within five days after the opening of the bid or proposals.[63]

(b.2)k. Appealing on a small business status

Appeals regarding a dismissal of an application for the grant of a small business status are heard by The Size Appeals Board.[64] The appeal can be submitted by any concern or interested party which has protested against the small business status of another business bidding or offering for a Government procurement or sale,[65] or by a concern or interested party whose application for assistance under the **Small Business Investment Act 1958** has been rejected,[66] or by a concern or interested party which was affected by an industrial sub-division decision,[67] or by the Associate Administrator of a particular Small Business Administration programme.[68]

There is no restriction as to the time within which an appeal regarding a size determination, or a product classification, must be submitted, except when it concerns Goverment procurements and sales, in

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62 13 CFR Sec.121.3-2(v). (Rev.13, Amdt.19, 43 FR 13498 Mar. 31, 1978).

63 13 CFR Sec.121.3-5(a) (Rev.13 Amdt.19, 43 FR 13498 Mar. 31, 1978).

64 13 CFR Sec.121.3-6(a) (Rev.13, Admt.19, 43 FR 13498 Mar. 31, 1978).

65 13 CFR Sec.121.3-6(b)(4)(i) (Rev.13, Amdt.19, 43 FR 13498 Mar. 31, 1978).

66 Ibid., Sec.121.3-6(b)(1)(ii).

67 Ibid., Sec.121.3-6(b)(1)(iii).

68 Ibid., Sec.121.3-6(b)(1)(iv).

which a decision is urgently needed on account of the imminent procurement or sales dates. On such occasions, a 5- to 10-day period from the beginning of the bidding or offering is allowed for Appeal submission.[69] Ten days are allowed in cases where the bidding's opening date, or the last proposal submission date, is **more** than 30 days after the issue of the invitation for the bids, or requests for proposals of quotations; and five days, in cases where the bids or proposals for quotation ought to be submitted **less** than 30 days after the invitation[70] was issued.

No specific format is required for the Appeal, besides its submission on an original typescript with one legible copy. In cases of Government procurement or sales, one copy has to be sent by the appellant to the Contracting Officer and one copy to the Regional Office.[71]

Appeal details

The following details have to be incorporated in the appeal:

1. Name and address of concern to which the size determination applies.[72]
2. The determination which is appealed upon and its date.[73]
3. In cases of Government procurement contracts and/or sales, the contract number and name and address of the Contracting Officer.[74]
4. Enumerations and reasons for the allegedly erroneous decision

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69 Ibid., Sec.121.3-6(b)(3).

70 Ibid., Sec.121.3-6(b)(3)(ii).

71 Ibid., Sec.121.3-6(b)(4).

72 Ibid., Sec.121.3-6(b)(4)(i).

73 Ibid., Sec.121.3-6(b)(4)(ii).

74 Ibid., Sec.121.3-6(b)(4)(iii).

of the relevant determining officer.[75]

5. Arguments supporting the former allegations.[76]

6. The remedy anticipated by the applicant.[77]

The Board does not generally review issues or evidence which were not previously presented to the Small Business Administration office that made the original size determination, unless special loss was caused to the appealing party, due to no fault or negligence of his own.[78]

After the lodging of an appeal, any other interested parties may file with the Board a signed statement giving reasons why the appeal should be accepted or dismissed. These statements have to be sent to the Size Appeal Board within five days of the receipt of the notification of the appeal, and copies of the statements have to be sent to the appealing concern.[79]

The Size Appeal Board bases its decisions on the written, and any other, evidence submitted, including oral evidence if it is considered necessary, after which a prompt decision, stating the reasons thereof, must be issued by the Board.[80]

(b.2)1. Reconsideration of a small business status

There exists a further form of appeal against the decision of the Size Appeal Board. This second appeal is not to a higher or different authority, but to the same Size Appeal Board. It is therefore referred to as a "reconsideration", rather than an appeal. A request for

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75 Ibid., Sec.121.3(b)(4)(iv).

76 Ibid., Sec.121.3-6(b)(4)(v).

77 Ibid., Sec.121.3-6(b)(4)(vi).

78 Ibid., Sec.121.3-6(b)(4).

79 Ibid., Sec.121.3-6(d).

80 Ibid., Sec.121.3-6(e).

reconsideration has to be submitted within 10 days following the receipt of the Board's written findings and decision.

Grounds for reconsideration could be: a material error of fact in the Board's original decision; or facts not previously available to the petitioner, through no fault of his, and therefore not considered by the Board.[81]

The Chairperson of the Board, who has the right to deny or grant the request for reconsideration, has to notify the interested parties of his decision. Should the Chairperson refuse permission for reconsideration there exists no further remedy to the petitioner. Where, however, the Chairperson grants permission for reconsideration the Board has discretion as to which information should be made available to the parties.[82] The "reconsideration" decision by the Board is final, and no other administrative or legal remedy is available.[83]

Guidelines offered by the regulations to the Chairperson, regarding grounds for summary dismissal of Appeals and request for reconsideration, are: late submissions; lack of detailed specification of the alleged error in size or classification determination; the Appeal being outside the Board's jurisdiction; lack of apparent support for the allegation of error in the previous decisions; Government contracts which have already been awarded; requests for reconsideration not revealing new factual evidence; and Appeals that are chiefly based upon issues and evidence which the appellant has unreasonably failed to present in his previous request for classification.[84]

In cases of pending Government procurement or sales, such a

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81 Ibid., Sec.121.3-6(g)(3)(i)(ii)(iii).

82 Ibid., Sec.121.3-6(g)(4).

83 Ibid., Sec.121.3-6(g)(5).

84 Ibid., Sec.121.3-6(h)(1);(2);(3);(4);(5);(6);(7).

summary dismissal by the Chairperson is final, owing to the lack of time needed to review the decision, and due to the fact that whatever damage has been done to the requesting concern, its effects cannot be rectified, as they cannot be assessed in any practical and realistic manner.

Summary dismissals by the Chairperson, due to late submissions, have to be referred to the Board for a decision regarding a future eligibility to procurement, sales or other Small Business Administration assistance programmes.[85]

(b.2)m. Comments

The regulations of the **Small Business Act** have paid detailed attention to the method of calculating the number of employees and to the appeal procedure on status certification, mainly because of the great financial advantages gained by a concern's classification as a small business, a fact that prompts also some unmeriting and many border-line concerns to vie for the title.

The unusual procedure of "reconsideration", which opens an additional channel for appeal on administrative decisions, ought to be seen as a genuine effort by the legislation to minimise the effects of arbitrariness.

(c) Small Business Defined by the Exclusive Method of Definition

The category of legislation that defines the small business by the exclusive method of definition uses the employment criterion in order to establish the size of the business entitled to the exemptions from duties. Such definitions do not use the term "small business", and the deduction that this is what they nevertheless mean is based on the low numerical specifications of the determinants (those that one associates with small business) which they use.

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85 Ibid., Sec.121.3-6(h)(7).

Because these definitions do not clearly state the status of the defined, they are open to interpretation and therefore ought to be examined carefully in order to verify whether the exemptions have been intended to serve as small business definitions, or just as exemptions per se.

In this category are included:

The **Fair Labor Standards Act 1938 – Regulations.**

The **Age Discrimination in Employment Act 1967**

The **Communications Act 1934 – Regulations.**

The **Federal Water Pollution Control Act 1972 – Regulations.**

The **Occupational Safety and Health Act 1970** (OSHA) – Regulations.

(c.1) The Fair Labor Standards Act 1938 – Regulations

Section 7 of the **Fair Labor Standards Act 1938**[86] provides for overtime pay rates for employees, and Section 13(b) allows for exemptions from it. The number of employees is used by the regulations as a definition of the following exempted employers:

1. Establishments classified by the term "country elevator" which employ not more than five employees.[87]
2. Public agencies responsible for fire protection, or law enforcement, that employ not more than five employees.[88]
3. Employers in forestry and lumbering operations who employ not more than eight employees.[89]

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86 June 25, 1938, Ch.676, Secs.1-19 52 Stat.1060, as amended: 75 Stat.65; 29 USC 201-219.

87 29 CFR Sec.213(b)(14). A "country elevtator" is a grain storage depot that consists of a silo and a shop.

88 29 CFR Sec.213(b)(20).

89 29 CFR Sec.213(b)(28).

Of the three exempted classes of employer, those listed under (2) are of no relevance to the present study, since "public agencies"[90] are not properly businesses and are therefore not relevant to the definition of small business; while the exemption of the employer of eight employees in the forestry and lumbering industry[91] is not understood - even by the Congress that authorized an investigation into the matter.[92]

This leaves only the "establishment commonly recognised as a **country elevator**, including such establishments which sell products and articles used in the operation of a farm, provided that no more than five employees are employed in the establishment in its operation"[93] as a focus for the analysis of whether the exemption constitutes a small business definition or not.

The legislator's motives for granting an exemption are important, as they might indicate whether the exemption has been granted to the business because it was considered small, which could then be interpreted as a small business definition; or for other reasons. Regarding the present legislation, an observation that might help to understand the legislator's reasons is that the exemptions from overtime rates have been worded in such a manner that it seems as if the exempted are the "employees" rather than the "employers", as can be seen from the following excerpts:

> "Any employee employed ... by an establishment commonly known as a country elevator ... provided, that no more than 5 persons are employed ... is exempted from the overtime provisions of section 7 of the Fair Labor Standards Act."[94]

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90 Supra, note 88, p.243.

91 Supra, note 89, p. 243.

92 Sec.13 of PL 87-30 authorised a study and re-examination of the reasons that exempted the forestry and lumbering sector from the overtime provisions of the Act.

93 Supra, note 87, p.243.

94 Sec.13(b)(14) of the Fair Labor Standards Act (as amended), CFR 780,701, p.608.

and:

"Any employee engaged in ginning of cotton ... or in the processing of sugar beets."[95]

Similar wording, whereby the Act referred to the employees as the exempted, has been used in exemptions from the "minimum wages and maximum hour requirements" of Section 206:

"Any employee employed as a home worker..."

"Any employee employed in American Samoa..."

"Any employee employed in agriculture..."

In all, the Act exempts eight types of enterprises from the minimum wage requirements and 28 from the maximum hour regulations; and all these exemptions are phrased in a manner that gives the illusion that the employee is exempted from some obligation, when in reality, it is the employer who is exempted from the obligations, and the employee who is excluded from the benefits. Had the exemptions been intended as a small business definition, they ought to have been granted to the employers, namely to the businesses. Why then have these exemptions been worded as if they were granted to the employee when in fact they benefit the employer who faces a lower wages bill, while the employee in the small enterprise is made to earn less than his comrade in the big enterprise?

It can be speculated that although the **Fair Labor Standards Act 1938** was promulgated fundamentally in order to safeguard the interests of employees, its proponents were not oblivious to the perils of the small businesses and organisations which could not abide by all the privileges which the Act had granted to workers without ceasing to operate altogether. And as the Act did not seek the closure of small businesses, which would have caused an irrecoverable economic loss to the

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95 Sec.13(b)(15) of the Fair Labor Standards Act (as amended), 29 CFR 780.801, p.616.

country and the community as a whole, in addition to the financial loss caused to the owners themselves, it was intended to exempt them from some of its stringent requirements. But as the Act could not announce such a concession, while its declared aim and raison d'être were intended to be the safeguard of the employees' interests, the exemptions were worded in such a manner that they seemed to exempt the employees, whereas in reality they exempted the employers.

This view is supported by the regulations regarding the "country elevator", which try to explain and justify the exemption as not biased in favour of the employer, but in favour of the consumer and the community as a whole, namely, the famers who use the services of a "country elevator". The sacrifice of workers' benefits for the sake of granting better operating conditions to the employers would have been rejected outright, but the sacrifice of workers' benefits for the sake of ameliorating the conditions of the community as a whole, can be presented as an unbiased, objective ruling.

A further indication that the exemption was meant for a small business is the title of Subpart H of the regulations,[96] which refers to "Employment by Small Country Elevators within Area of Production". This supports the assumption that the Administrative Regulator intended the exemptions for small employers, although they seem to be attached to the employees. Still, proving that the exemption is granted to the small employer, does not answer the question of whether it was intended or could serve as a small business definition. For an answer to this, it will be necessary to refer to the interpretations offered by the regulations and the courts regarding the application of this exemption.

The Act deals with an establishment, not a business or a concern.

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96 29 CFR Subpart H. p.608.

The courts have interpreted "establishment" to mean a distinct physical place of business, which may be operated by an organisation.[97] Where such a business organisation operated several "country elevators", each individual "elevator", or place of business, could constitute an establishment within the meaning of the Act.[98] The use of the term "establishment" instead of "business" was intended to prevent situations where a business could own and manage many "country elevators", each with not more than five employees, thus reaching a total of over 500 persons (which exceeds the Small Business Administration's definition of a small business), and still not pay workers overtime rates, because in each of its "country elevators" it had five employees or fewer. By exempting an "establishment" and not a business organisation, this was prevented.

Usually, because "country elevators" are one-unit buildings, it is easy to determine their physical boundaries, but where they use other premises, for related but not principal functions of a "country elevator", such as storage of grain, a determination must be made as to what constitutes an "establishment". The determination should take into account these premises' proximity to the "elevator" and whether they are related to its operations, or whether the different functions constitute a separate business. Where the enterprise operates in more than one building, it must be determined by which establishment the employee is employed,[99] and whether that establishment meets the Act's requirement.[100] Since it is the employer who seeks to take advantage of the exemptions, though they were granted to the employee, it is he who has

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97 Phillips v. Walling, 334 US 490. Mitchell v. Bekins Van & Storage Co., 352 US 1027.

98 Tobin v. Flour Mills, 185 F.2d 596.

99 Mitchell v. Cammill, 245 F.2d 207. Remington v. Shaw (WD Mich), 2 WH Cases 262.

100 29 CFR Sec.780.705, p.609.

to prove that the conditions for the exemption exist.[101]

The regulations[102] and the courts[103] have dealt with the unique features of "country elevators" and their services to the community. They are located along railroads, towns or rural areas near grain farms, and have facilities especially designed for receiving bulk grain from the local farmers.[104] The main function of such elevators is to provide a place for the initial storage of grain grown in their locality, from which it may be despatched to its destination. This enables an even and orderly movement of grain over the interstate network of railroads, from the production areas to the terminal elevators, markets, mills, processors, consumers and export markets. Their secondary function is to sell various merchandise needed by the local farmers, such as feed grains, fuel for farm machinery, seeds, fertilisers, chemicals, twine and farm hardware.[105] The selling of such additional products has to be a sideline and not the main function of a "country elevator", if the five-employee rule is to apply.

It seems that the underlying justification for depriving the employees of small "country elevators" from the higher overtime rates is the fear of the adverse effects the higher wages could have on the availability and price of the services offered to the farming community by the "country elevators". In other words, the exemptions are the result of a strong farmers' lobby.

Generally, the number of five employees is congruent with the size

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101 Arnold v. Kanowsky, 361 US 388, 395.

102 29 CFR Sec.780.707, p.609.

103 Tobin v. Flour Mills, supra, note 98, p.247; Mitchell v. Sampson Construction Co., (D Kan), 14 WH Cases 269.

104 29 CFR Sec.780.708, p.610.

105 Tobin v. Flour Mills, supra, note 98, p.247; Holt v. Barnesville Elevator Co., 145 F.2d 250.

of many small businesses and could therefore serve as a small business definition; but as this numerical specification is associated with the particular aims and background of the exemption granted to the "country elevators", it cannot act as a general small business definition. Further proof that the Act never intended to define a small businesss can be found in Section 13(b)(15) of the **Fair Labor Standards Act 1938**, which exempted from the application of overtime rates:

> "Any employee engaged in ginning of cotton for market, in any place of employment located in a country where cotton is grown in commercial quantities, or in the processing of sugar beets, sugar-beet molasses, sugar cane or maple sap into sugar or syrup."

Here the exemption is clearly because of the type of work carried out, not because of the small number of employees. This precludes the exemption from acting as a definition of a business, let alone a small business. Similarly, the exemption granted to "country elevators" can be considered an exemption for a type of work and not a type of business, thus barring it from being considered as a definition of a small business.

(c.2) The Age Discrimination in Employment Act 1967

The **Age Discrimination in Employment Act 1967**[106] considers an employer as one who employs more than 25 persons:

> "... a person engaged in an industry affecting commerce who has 25 or more employees for each working day in each of 20 or more calendar weeks..."[107]

This definition applies only to privately owned businesses,[108] while State-owned enterprises are obliged to adhere to the Act regardless of the number of their employees.[109]

Because the Act does not consider the employer of fewer than 25

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106 81 Stat. 602; 29 USC 620; 5 USC 301.

107 Sec.11(b).

108 29 CFR Part 860, p.797.

109 29 CFR Sec.860.34.

persons to be a proper "employer", it grants him automatic exemption from any of its impositions. In this Act, unlike the **Fair Labor Standards Act**, the exemption is granted because of the size factor, and not because of the type of work, such as the cotton ginning; or the location, as in the case of the "country elevator". The present legislation is different from those previously encountered in that it defines only the included, and relies on the resulting deduction to define the excluded.

(c.3) The Communication Act 1934 – Regulations

The regulations authorised by the **Communication Act 1934**[110] have used the employment criterion on several occasions. Those relating to broadcast radio service,[111] have used it on five occasions,[112] and those regarding cable television systems[113] and international fixed public radio communication services on one occasion each.[114] Altogether, the employment criterion has been used seven times and always in the same context – that of exempting from submitting an "equal employment opportunity program".

It is a condition for the grant of a license or permission to operate any communication device that such a programme should be

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110 June 19, 1934, (S.3285) P.L. 416.

111 47 CFR Subchapter C - Part 73, p.4.

112 Part 73 - Radio Broadcast Service 47 CFR
(i) Subpart A-AM Broadcast Services, Sec.73.125(c).
(ii) Subpart B-FM Broadcast Services, Sec.73.301(c).
(iii) Subpart C-Noncommercial Education FM Broadcast Station, Sec.73.599(c)
(iv) Subpart E-Television Broadcast Station, Sec.73.680(c).
(v) Subpart F-International Broadcast Stations, Sec.73.793(c).

113 Cable Television System, 47 CFR Sec.76.311(b)(1)(2).

114 International Fixed Public Radiocommunication Services, 47 CFR Part 23, Sec.23.55(c)(1)(i)(b).

implemented:[115]

"Each station shall establish, maintain and carry out, a positive continuing programme of specific practices designed to assure equal opportunity in every aspect of station employment policy and practice."

"(c) Applicants for ... [a] licence ... shall file with the Commission [The Communication Commission] programs designed to provide equal employment opportunities for Negroes, Orientals, American Indians, Spanish-surnamed Americans, and women....."[116]

For cable television systems the programme consists of:

1. Defining the responsibility of each managerial level in order to enable the verification and pursuance of those responsible for the implementation of equal employment opportunities.
2. Informing the employees and their representative organisations of the equal employment opportunities policy.
3. Disclosing the existence of the equal employment opportunity policy to qualified applicants without regard to race, colour, religion, national origin or sex.
4. Continuous exclusion of every form of prejudice or discrimination.

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115 The Regulation relating to Radio Broadcast Services (47 CFR part 73) has introduced the equal employment opportunity clauses in the following legislations: 35 FR 8827, June 6, 1970, as amended at 36 FR 25013, Dec. 28, 1971; 42 FR 43848, August 31, 1977.

The Regulations relating to Cable Television System (47 CFR part 76) introduced the clauses in the following legislations: 37 FR 6590, Mar. 31, 1972, as amended at 37 FR 7083, April 8, 1972; 37 FR 25845 Dec. 5, 1972; 41 FR 32429 August 3, 1976; 41 FR 53996 December 10, 1976.

The Regulations relating to International Fixed Public Radio Communication Services introduced the equal employment opportunity clause in the following legislations: 25 FR 12894 August 14, 1970; as amended at 18 FR 3119 Feb. 18, 1971; Redesignated at 38 FR 22481 Aug. 21, 1973.

116 Guidelines for the preparation of such programmes are provided in the Commission's "Report and Order, Nondiscrimination in the Employment Policies and Practices of Broadcast Licencees", 60 FCC 2d 618 (1976).

5. Continuous review of job and employment practices, in order to ensure genuine equality of occupation.[117]

The regulations concerning cable television system[118] and international fixed public radiocommunication services[119] go even further and instruct the actual actions and procedures that ought to be undertaken by the licensee, such as:

1. Posting notices in the employer's office, informing employees of their equal opportunity rights, and their right to notify the appropriate agency if they believe they have been discriminated against. Where a significant percentage of employees or applicants are Spanish-surnamed Americans, such notice has to be in Spanish and English, or other languages as appropriate.
2. The notice has to be in bold type, and it has to inform prospective employees that discrimination because of sex, colour, race or national origin is prohibited, and that they have a right to notify the appropriate agency if they believe they have been discriminated against.
3. Placing employment advertisements in media that have significant circulations among minority-group people in the recruiting area.
4. Recruiting through schools and colleges with significant minority group enrolments.
5. Maintaining systematic contact with minority and human relations organisations to encourage referral of qualified minority or female applicants.

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117 47 CFR Sec.76.311. The same wording is used in all the other sections dealing with equal employment opportunities.

118 47 CFR Sec.76.311(2)(i)(a-g).

119 47 CFR Sec.23.55(2)(1)(a-g).

6. Encouraging present employees to refer minority or female applicants.

7. Whenever the operator hires he has to inform the appropriate recruitment sources in the area that qualified minorities and females are being sought for consideration.

All licensees (in the USA all civilian communication operators are licensees) have to submit to the Communication Commission proposals for such an equal opportunities procedure, stating all the specific practices that they propose to follow. This does not apply to a licensee who employs not more than five full-time employees, or not more than 16 full-time employees if he holds an international fixed public radio communication services licence.[120]

In fact the exemption is not from the implementation of an equal employment opportunity policy, but from submitting a written programme to the commission. As such it is just an exemption from a paperwork requirement – a type of exemption commonly granted only to small businesses, which find it one of the heaviest burdens of Government regulations. Although paperwork exemptions are identified with small businesses, their value as small business definitions is diminished because they are only exemptions from technicalities.

(c.4) The Federal Water Pollution Control Act 1972 – Regulations

The **Federal Water Pollution Control Act 1972**[121] authorises the Administrator of the Environmental Protection Agency (EPA) to issue guidelines for the discharge of pollution resulting from electro-plating processes.[122] On March 28, 1974, the Environmental Protection Agency issued effluent guidelines for existing electro-platers and for new sources.

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120 47 CFR Sec.23.55(b).

121 P.L.92-500 86 Stat.816.

122 40 CFR Sec.413.20, p.200.

The guidelines were considered by the industry to be of a very severe nature, and as a result the EPA published on November 14, 1974 a "Notice of Proposed Reconsiderations",[123] inviting comments and additional data. Next, on April 24, 1975 the EPA published a revised regulation[124] allowing non-precious metal platers with under 11 employees (and having certain water usage and plating production characteristics) to meet only those requirements for destruction of cyanide and adjustments of pH.

Usually, a regulation would first enumerate the duties it imposes, and only later state the qualifications needed for general or partial exemptions. The present case is different in that the regulation has created a tiering. That is to say, that it did not set out a general guideline and exempt the employer of under 11 persons from all or part of it, but formulated two sets of guidelines, one for those with more than 11 employees, and one for those with fewer. Technically, this is not an exemption, but a different obligation - especially as the EPA referred to it as an "accommodation" rather than an "exemption".[124]

Legislations in the area of environmental protection have been on the increase since the last decade. Their aims and those of small business do not coincide, and occasions when any business, even a small one, has been exempted from their jurisdiction are rare. As seen in the electro-plating industry, the Environmental Protection Agency altered its guidelines for small businesses only after pressure from the affected parties.

The regulations themselves did not define the small business either directly or by exemption, but used the tiering technique. Since the

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123 39 FR 40170 Nov. 14, 1970.

124 40 FR 18130 Apr. 24, 1975. It includes a table of permitted levels titled "Accommodation to Size in EPA Regulations".

"accommodation" is very specific and technical, it would be too removed from the reality of the business world to claim that the choice of a dividing-line of 11 employees constitutes a definition of the small business sector.

(c.5) The Occupational Safety and Health Act 1970 (OSHA) - Regulations

Only once do the Regulations of the **Occupational Safety and Health Act 1970 (OSHA)**[125] use an employment criterion, and that is for the exemption of businesses with not more than 10 employees from some record-keeping procedure.[126] A House of Representatives Bill proposal[127] suggested an amendment - that the Act should not apply to employers with 25 or fewer employees - but so far the Bill has not been passed.

The Act's Regulations require the keeping of a log and summary of occupational injuries and illnesses on three similar and overlapping forms:[128] OSHA 200 for occupational injuries and illnesses of each employee; OSHA 101 for more detailed reporting than OSHA 200; and OSHA 102 for a summary of OSHA 200. The Regulations exempt the employer of less than 10 persons from the completion of forms OSHA 101 and OSHA 102, and required only the completion of form OSHA 200. Though this exemption from keeping two forms is titled "small employers" it is too negligible to be considered as a small business definition.

During the second session of the 95th Congress, a Bill[129] suggesting some relief to small business from the **Occupational Safety and Health Act** requirements was placed on the Senate floor by Senator Bartlett. The Bill as approved by the Congress provided that no civil penalty shall be proposed or assessed for any first-instance safety

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125 PL 91-596 84 Stat.1590.

126 29 CFR Sec.1904.15, p.42.

127 HR 3783

128 29 CFR Secs.1904.2; 1904.4; 1904.5; 1904.8.

129 HR 11445.

and health violation, if the employer cited for such violation had not more than 10 employees.[130] The provision did not become law, as a result of a Presidential veto.[131]

The aspect of a business's size was considered relevant also with regard to penalties:[132]

> "The Area Director shall determine the amount of any proposed penalty, giving due consideration to the appropriateness of the penalty with respect to the size of the business of the employer being charged....."

The size of the enterprise was interpreted by the internal guidelines[133] of the Occupational Safety and Health Agency, as the number of employees of an enterprise, and the penalties were imposed accordingly:

10 and under employees: 40% reduction in penalty payment;

11-25 employees: 30% reduction in penalty payment;

26-60 employees: 20% reduction in penalty payment;

61-100 employees: 10% reduction in penalty payment.

Fines of $25 or less were excluded from the above tariff scale, as a reduction on such a small sum was thought to be inconsequential.

(d) Summation

The survey of the US legislation that has used the employment criterion indicates that:

(a) Legislative acts or sections thereof that have been intended to benefit small businesses have used the positive method of definition, and have specified a higher number of employees as the determinant of their definition than legislation that used the exclusive method of definition.

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130 House of Representatives Report No.95-1671, HR 11445, Sec.120(a).

131 The bill was vetoed on Oct. 23, 1978 by the President.

132 29 CFR Sec.1903-15(b).

133 Details obtained from OSHA employees.

(b) Legislation intended to benefit others than the small business, for example employees or the environment, has used the exclusive method of definition; and the number of employees which serves as a determinant for the definition of the exempted or the excluded is much lower than that in the legislation intended to benefit small business.

Since the promulgation of the **Small Business Act**, legislative acts designed to promote or assist small businesses have adopted its small business definition. Some have fixed their numerical determinants according to the **Small Business Size Standards** regulations, while others have decided their own. The average number of employees of the definitions that used the positive method was 500 persons, while that of legislation that used the exclusive method was only 12 persons.

The existence of such a marked discrepancy in respect of number of employees between legislation using the positive method of definition and that using the exclusive method, indicates that when the legislator has used the exclusive method of definition and relied on low numerical determinants he has been aiming at restricting the numbers of the exempted, and not at defining small businesses.

(ii) The Employment Criterion in the Legislation of the People's Republic of China

The legislation described in this chapter was all promulgated between 1950 and 1953, before the Cultural Revolution and the rule of the "Gang of Four"; at this time the economic philosophies of the People's Republic of China were not rigidly applied. This meant that although from an ideological point of view private enterprise was scorned and restricted in size, in practice the State endeavoured to create a system of

co-operation between itself and the private sector.[134] This situation persisted until the onset of the Cultural Revolution, which wiped out not only most of the small undertakings that were privately owned, but also many of those owned by co-operatives and the State.

As a result of the regime's preference for larger-scale industries that are easier to control in a planned economy, the legislation described here which relied on the employment criteria to differentiate between small and larger enterprises, has long not been operative, on account of the lack of small businesses, from which it was necessary to differentiate the larger ones. Simultaneously with the decline of the small business sector, the role of the trade unions in it diminished until it became virtually non-existent. Consequently legislation that used employment criteria in the context of trade union activities[135] was left in abeyance, neither abolished nor active.

The present regime is confronted with the task of re-introducing small scale enterprises into the private and co-operative sector, without contradicting the present Constitution, which scorns the employment of others.[136] It can be seen that despite the present regime's efforts to re-introduce small businesses into the economic structure of the country, their size will have to stay small in view of the ideological shackles that restrict their spontaneous development.

From a legal point of view the legislation dealt with here is valid, because it has not been abolished. Furthermore, with the re-introduction of the "rule of law" to the People's Republic of China, these laws might

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134 The directive on Labour-Capital Consultative Councils in Private Enterprises, 1953, deals with the co-operation between the State and the private sector. See p.364.

135 The Trade Union Law of the People's Republic of China 1950. See p. 260.

136 Articles 5, 7 of the 1978 Constitution.

play an active part in the economic life of the country, if not because of their intrinsic value, then at least for the lack of more suitable legislation.

(a) The Decisions Concerning the Differentiation of Class Status in the Countryside 1950

The **Decisions Concerning the Differentiation of Class Status in the Countryside 1950**[137] are regulations that supplemented[138] the **Agrarian Reform Law** of the People's Republic of China,[139] and aimed to classify the whole population in two categories: "exploiters" or "non-exploiters"; terms synonymous with employers and workers. In rural areas the assignation of a peasant to the class of "exploiters" was determined according to the quantitative criterion of the number of workers he employed;[140] while in the urban areas it was the qualitative aspect of his employment of them: whether they were taken on to aid the employer's own toil, or in order to allow him to derive profit from it.

The "exploiters" of the rural population were the "rich" and "middle" peasants. The "rich" peasants[141] employed two long term workers, and the "middle peasants"[142] one. The hirer of two casual labourers for a maximum period of 120 days a year each was considered a "middle peasant", as this was calculated to be the equivalent of one long-term labourer.[143]

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137 Albert P. Blaustein, Fundamental Legal Documents of Communist China, Fred. B. Rothman & Co., South Hackensack, New Jersey, 1962, p.291.

138 They were adopted by the Government Administrative Council of the Central People's Republic on Aug. 4, 1950.

139 The law was promulgated by the Central People's Government on June 30, 1950.

140 Blaustein, supra, note 137, Ch.3, Sec.B., p.303.

141 Ibid., Ch.3, Sec.B1.

142 Ibid., Ch.3, Sec.B2.

143 Ibid., Ch.3, Sec.B4.

The urban "exploiters" were the handicraft producers, who were divided into "small" and "capitalists", and the "commercial capitalists" who were the merchants. As a rule the "small" producers did not hire labour[144] except the occasional assistant or apprentice, and then they were equated with "middle peasants" who employed one labourer. The "capitalist" producers[145] and the "commercial capitalists"[146] were deemed "exploiters" because they profited from other persons' labour, irrespective of the numbers they employed, which could be as low as one. This attitude did not apply to professional workers who hired assistants to help them in domestic labour, and they were not considered exploiters.[147]

(b) The Trade Union Law of the People's Republic of China 1950

The **Trade Union Law**[148] set out to define the legal status functions and duties of the trade union organisations, in order to improve the organisation of workers.[149]

The employment criterion was used by the Law on two occasions, in Articles 13 and 15. Article 13[150] used the numerical determinant of

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144 Ibid., Section III, "Some New Decisions Adopted by The Government Administration Council", par.1, p.321.

145 Ibid., par.2.

146 Ibid., par.6.

147 Ibid., par.4.

148 Blaustein, supra, note 137, p.259.

149 The Law was adopted on June 28, 1950 by the Central People's Government Council at its eighth session.

150 Article 13. "In factories, mines, business establishments, farms, institutions, schools and other productive or administrative units with 25 or more workers and staff members, a primary trade union committee may be set up (such as a factory, mine or institution committee). In those employing less than 25 persons an organizer may be elected, who shall have the same rights as a primary trade union committee. The regulations governing the organization of primary trade union committees shall be formulated by the All-China Federation of Trade Unions or the national committees of the respective industrial unions."

25 workers in two ways: once in the first part of the Article as a lower threshold - "with 25 or more workers"; and once in the second part as an upper threshold - "less than 25 persons". The Law stipulated that workplaces with more than 25 workers were to have a trade union committee, while those with less than 25 workers needed only a union organiser and not a committee. The division of industry into two sections, of over and under 25 workers, can only have the practical purpose of safeguarding productivity. It was recognised that the participation of workers in management and/or union activities, though hailed as "the democratic rule of the people", was disruptive to production. So as to ensure that a small unit should not lose 3-4 productive workers on the Committee benches, the Law took the size factor into consideration, and differentiated between a size needing a Committee, and a size which required only a single organiser.

Article 15[151] distinguished between enterprises with over and under 200 employees and specified the required number of full-time trade union functionaries for those with more than 200 employees. Smaller units with less than 200 workers were not required to employ full-time union

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151 Article 15. "The number of members of a primary trade union organization who are full-time trade functionaries shall be determined in accordance with the total number of workers and staff members employed in each factory, mine, business establishment, farm, institution, school and other productive or administrative unit. The ratio shall be as follows:

Number of workers and staff members	Number of full-time trade union functionaries
200-500	1
501-1000	2
1001-1500	3
1501-2500	4
2501-4000	5

Another full-time trade union functionary may be added for every additional two thousand workers and staff members in units employing over four thousand workers and staff members. When necessary, primary trade union committees in units employing less than two hundred workers and staff members may have one full-time trade union functionary upon the approval of a higher trade union committee."

functionaries, but could if they wanted, "upon the approval of a higher trade union committee" that thought "it was necessary".

This law resorted to two different numerical determinants for the purpose of exempting from two different duties. A reduction in the enterprise's size was accompanied by a reduction in its duties. The smallest unit with fewer than 25 employees was exempted from two duties, those imposed by Articles 13 and 15; the medium-sized unit, with more than 25 employees and less than 200, was exempted from one duty only, that which was imposed by Article 15; and the large unit with over 200 employees had to abide by both Articles.

Despite the fact that such enterprises were exempted from duties because they employed fewer workers, their exemptions cannot be interpreted as a small business definition because the Law used different determinants for the exemption from different duties, which indicates that the size definition of 25 or 200 employees was intended for the very specific requirements of articles 13 and 15 and not as a general definition of small enterprises.

(c) The Labour Insurance Regulations of the People's Republic of China 1953

The Labour Insurance Regulations[152] were formulated in 1951 and amended in 1953[153] to include more industries, increase the benefits, and dispense with certain time limits on the entitlement of workers' benefits.

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152 Blaustein, p.534, supra, note 137, p.259.

153 First promulgated on Feb. 26, 1951 by the Government Administration Council. Amended on Jan. 2, 1953, by the Government Administration Council.

Article 2(a) of the Regulations[154] defined part of their jurisdiction, and exempted enterprises employing less than 100 employees from compliance.

In contrast with the **Trade Union Law**, the use of the employment criterion by these Regulations is more suitable as a small business definition because it exempted enterprises from all the Regulations' impositions, while the **Trade Union Law** exempted only from specific obligations. What prevents it, however, from acting as a small business definition is its temporariness. "At present, the scope with which the Regulations are to be applied should be temporarily confined", among other things, to those "employing-100 or more workers..."[155] The temporariness of the determinant prevents it from acting as a definition, because it indicates that the Regulations did not consider the 100 employee threshold a genuine division between different types of enterprises.

(d) Labour–Capital Consultative Councils in Private Enterprises (Directive) 1950–1957

The **Labour Capital Consultative Councils in Private Enterprises (Directive)**[156] are guidelines issued by the Ministry of Labour,[157] relating to the establishment of councils comprising employers

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154 Article 2. "In carrying out the present Regulations, the method of gradual extension to include more and more enterprises shall be adopted. At present, the scope within which the Regulations are to be applied shall be temporarily confined to the following enterprises:
(a) State, joint State-private, private, or co-operative owned factories and mines, employing 100 or more workers and staff members, and their ancillary units..."

155 Ibid.

156 Blaustein, supra, note 137, p. 259.

157 The date of the directive is unknown, but is believed to be in the early 1950s, because it refers to private enterprises, which were still in existence then. In the late 1950s their numbers were reduced dramatically, until they virtually disappeared at the beginning of the 1960s.

and employees, for the purpose of conducting consultations on problems concerning the improvement of production, business and labour relations.

These councils were not to be forced on the private enterprise sector, but were to be set up by the mutual consent of the employers and the employees.[158]

Although the setting up of these councils was not obligatory, it seems that it was "advisable" for enterprises employing more than 50 workers, because Sec.2 of the Directive states that it "shall in general be established in privately owned factories, or business establishments employing 50 or more persons." The enterprises that employed fewer than 50 persons were not advised likewise, as they "may do so as they see fit in accordance with the actual situation and in the spirit of the Directive."

This 50-employee determinant is unique inthat it applies only to the private enterprise sector, while the employment determinants of the other mentioned legislations did not distinguish between the private and the State-owned enterprises. Whether this recommends its use as a small business definition depends on whether the ownership element is a requisite of such a definition.

(e) Summation

The criterion of employment was used by the legislation of the People's Republic of China for two distinctly different aims - ideological and practical. For the first it was a "shibboleth" which distinguished those who engaged in the exploitative employment of others; and for the second it was a measuring instrument designed to relate numbers of employees to the practicality of compliance with rules and regulations.

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158 Sec.1 of the Directive.

When the criterion of employment was used for the ideological purpose of exposing the exploiters, the numerical determinants were in effect superfluous, since the mere inference that employment of others was practised was sufficient to consign the defined to a status of an exploiter; but when the employment criterion was used for the practical aim of determining a size of an enterprise, the numerical determinants were essential attachments to the criterion of employment.

The ideological function of the employment criterion in the **Decisions Concerning the Differentiation of Class Status in the Countryside** has at present been obliterated, not because this legislation has been abolished, but because the new economic philosophy of the People's Republic of China advocates a return to Mao Tsetung's "walking on two legs" philosophy,[159] in which small private industries live side by side with large State-owned ones. Furthermore, the official Chinese attitude at the moment is that the "class struggle" is over because it has been won by the people. Consequently, legislation dealing with class status would not now be likely to be enacted.

Of the legislation reviewed, only the employment criterion of 50 employees which was used by the directive on **Labour-Capital Consultative Councils in Private Enterprises** could be considered as a small business definition, because it applied to the private sector to which the majority of small businesses belonged and it dealt with the wider issue of business policy, rather than the more specific issues dealt with by the other legislations that used the employment criterion.

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159 See p.132.

(iii) The Employment Criterion in the Legislation of the UK

The legislation of the UK has used two methods of definition, the positive and the exclusive, in connection with the employment criterion. The positive method of definition was employed by:

1. **The Inner Urban Areas Act 1978.**
2. **The Employment Subsidies Act 1978.**
3. **Company Accounting and Disclosure – A Consultative Document – 1979.**

These measures referred to the small business by its name, and used the employment criterion for its definition.

The measures that employed the exclusive method of definition used it in two ways, by exemption and by exclusion. Amongst those that used the employment criterion for the definition of a defined according to "the exclusive method of definition by exemption", are:

1. **The Coal Industry Nationalisation Act 1946.**
2. **The Companies Act 1967.**
3. **The Sex Discrimination Act 1975.**
4. **The Industrial Training Act 1964 – Industrial Training Orders.**

The common feature of these Acts is that they have defined those excluded from their jurisdiction; while the legislation that used the "exclusive method of definition by exclusion" defined those that were included. In both cases of exclusion and inclusion, the determining factor was the number of employees.

Measures that used the exclusive method of definition by exclusion are:

1. **The Disabled Persons (Employment) Acts 1944 and 1958.**
2. **The Factories Act 1961.**

3. **The Offices, Shops and Railway Premises Act 1963.**

4. **The National Insurance (Industrial Injuries) (Claims and Payments) Regulations 1964.**

5. **The FirePrecautions (Factories, Shops, Offices and Railway Premises) Order 1976.**

The exclusive method of definition does not mention the defined by name; consequently its identity has to be deduced. In the case of the aforementioned measures, the question is whether the exemption or the exclusion of enterprises with a small number of employees constitutes a small business definition.

(a) The UK Positive Definitions of the Small Business

Of the three measures that have referred to small businesses by name, only one, the **Inner Urban Areas Act 1978**, relied exclusively on the employment criterion, while the other two used it in conjunction with other criteria.

(a.1) The Inner Urban Areas Act 1978

Section 11(3) of the **Inner Urban Areas Act 1978** defined a small firm:

> "In this section 'small firm' means an industrial or commercial undertaking which has no more than fifty employees."

The reason for the definition was the provision of grants towards loan interest to small firms.

The determinant of 50 employees is the same as that of **Company Accounting and Disclosure - A Consultative Document**, but smaller than the 200-employee upper threshold determinant of the Small Firms Employment Subsidy Scheme as authorsed by the **Employment Subsidies Act 1978.**

The **Inner Urban Areas Act 1978** is unique in that it is the only Act that defined the small business in a positive manner. The definition associated with the **Employment Subsidies Act 1978** appeared in a departmental guide-line, and the definition of the

Company Accounting and Disclosure is still at the stage of a consultative document.

(a.2) The Employment Subsidies Act 1978

The declared aim of the **Employment Subsidies Act 1978** was to authorise payments to employers as a means of contributing to the alleviation of unemployment. Section I(i) of the Act authorises the Secretary of State:

> "to set up schemes for making payments to employers which will enable them to retain persons in employment who would or might otherwise become unemployed, to take on new employees, and generally to maintain or enlarge their labour force".

In accordance with this authority, the Department of Employment set up the Small Firms Employment Subsidy Scheme. The original Scheme ran in certain parts of the UK from July 1, 1977, and has been replaced by the 1979 scheme, which was open for applications from January 1979 to March 1980.[160]

The Small Firms Employment Subsidy (SFES)[161] offered a subsidy of £20 a week to certain small firms for each additional job they provided. The scheme defined those small firms eligible to the subsidy as follows:

> "A firm may be able to receive SFES if it can show that it meets all the following conditions:
>
> It is a business in the private sector which is engaged in manufacturing activities;
>
> The total number employed by the firm (and any subsidiary concerns) in Great Britain and elsewhere on 9th November was less than 200;
>
> It is an independent business, that is not a subsidiary of another concern (whether that concern is in the public or private sector); except that a firm which is a subsidiary of another private sector concern may be eligible if total employment in both and any other subsidiary concerns was less than 200 on 9 November 1978."

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160 The original Scheme got its authorisation from the Employment and Training Act 1973.

161 For Manufacturing Firms in Great Britain: Small Firms Employment Subsidy, Department of Employment. Prepared by the Department of Employment and the Central Office of Information, HMSO, Dec. 1978, Dd 597053 P20 11931 150M 12/78. See also pp. 216-219.

This definition is the only one that has adopted the 200 employee criterion for the manufacturing sector which was first used by the Bolton Committee in 1971 in its definition of the small business.

(a.3) Company Accounting and Disclosure – A Consultative Document

Company Accounting and Disclosure is a consultative document presented to Parliament by the Secretary of State for Trade,[162] pursuant to the adoption in July 1978 of the EEC Fourth Directive on Company Law, which will require the UK to reform the law relating to company accounts.

The consultative document has classified the companies into three tiers: top, middle and bottom tier. In the bottom tier are found the small private companies, which were defined as follows:

> "Small private companies which do not exceed two of the following three criteria:
>
> - turnover of £1,300,000
> - balance sheet total of £650,000
> - average number of employees 50."[163]

This definition has defined only small companies, and not any small enterprise. It has relied on three quantitative criteria, each with its specific numerical upper threshold, and required the satisfaction of only two of them.

(b) The UK Small Business Definition – according to the Exclusive Method of Definition by Exemption

Prima facie, a definition according to the exclusive method of definition is not a definition per se, because it defines the defined only in an indirect manner. In the case of a small business the interpreter has to deduce whether the exemption of an enterprise with a given number of employees does or does not constitute a small business definition.

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162 Company Accounting and Disclosure - A Consultative Document, HMSO Sept. 1979, Cmnd 7654.

163 Ibid., p.1. In addition, the definition states that for accounting requirements, a subsidiary of a public company will not be treated as a small company. And any company within a group which, taken as a whole, does not conform to the criteria of a small company will not be treated as one.

(b.1) The Coal Industry Nationalisation Act 1946

The **Coal Industry Nationalisation Act 1946** established the public ownership and control of the coal-mining industry and certain allied activities.

The only coal-mining which was left to private enterprise was in mines which did not employ below ground more than thirty persons.[164] Permission to own and work such a mine was not gained automatically with the fulfilment of the condition of not employing more than 30 employees, but depended on a grant of a licence by the Coal Board. The licence could be an unconditional one, or subject to any conditions that the Coal Board decided to impose. Its duration could be indefinite, or subject to revocation,[165] depending on the Coal Board's decision.

The **Coal Industry Nationalisation Act 1946** used the employment criterion to differentiate between the large mines which were economically viable as part of a large nationalised organisation with centralised control, and the small mines, which were too small and therefore not viable under centralised planning and control. Since the exclusion of the small mines from the nationalisation take-over was due to their small size, it could be said that their exclusion constituted a small business definition for the coal industry.

(b.2) The Companies Act 1967

Section 18(5) of the **Companies Act 1967** exempts a company employing fewer than 100 employees from the obligation to disclose in its director's report the weekly average number of employees and their aggregate remuneration.[166]

This is the only instance of an employment criterion being used by the **Companies Acts**,[167] though other criteria have been

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164 Sec.36(2)(a).

165 Sec.36(2).

166 These disclosure requirements are demanded by Secs.18(1)(a) and 18(2)(a) of the Companies Act 1967.

167 Companies Act 1948; Companies Act 1967; Companies Act 1976.

employed for the exemption of a group or a sector from some of the Acts' requirements. The turnover criterion was used on several occasions for the exemption of a company from the disclosure of its turnover in the annual accounts,[168] from showing the classification of its sales structure,[169] and from reporting its export performance in the directors' report.[170] The criterion of emoluments was used to exempt a company from disclosing the number of its higher paid employees;[171] and loans were also used as a criterion to exempt disclosure in this area.[172] Common to all the exempting criteria is their affinity with the nature of the exemption. The employment criterion was used for the exemption from disclosure of the numbers employed, while the turnover criterion was used for the exemption from turnover disclosure.

(b.2.)(a) A concession is a definition.

Professor Schmitthoff regarded these exemptions as "a concession to the smallness of the companies", and not as an acknowledgement by the Act of their fundamental, functional and structural differences from big companies.[173] Even though one may agree with this, it seems reasonable to claim that a "concession to smallness" means an automatic acknowledgement of a uniqueness sufficient to identify those eligible for exemption, because the grant of a concession depends on the identification of the "concessionaire" (concession-receiver), which entails his isolation from the rest of the population, and the accentuation of his

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168 Sched.8, par.13A, Companies Act 1967. Turnover was fixed at £50,000. Since Feb. 7, 1972 it has been raised to £250,000 by the Companies (Accounts) Regulation 1971 (SI 1971, No.2044).

169 Companies Act 1967, Sec.17.

170 Ibid., Sec.20.

171 Ibid., Sec.8. The number of employees whose emoluments were over £15,000 had to be disclosed in the company's accounts.

172 Companies Act 1948, Sec.197. Loans to employees of over £2000 had to be disclosed in the company's accounts.

173 Prof. Clive M. Schmitthoff, "How the English Discovered the Private Company", in Quo Vadis Ius Societatum?, Libri Amicorum Pieter Sanders, Deventer, 1972, p.183.

differences.

A group in isolation, either due to inherent differences, or because of those acquired through the isolation, becomes a group separated from the majority of the population, and as such evolves into a separate entity. That the **Companies Act** did not accept small companies as fundamentally different from big companies becomes irrelevant, since once it exempted this group from obligations, it isolated it from the included and forced it to evolve a separate and independent identity from theirs.

A concession is a privilege granted to a select group, in accordance with the "concessor"'s discretion. It does not carry the same weight as a right, since it is usually not demanded as of right by the "concessionaire".

A right is a privilege granted to a wider section of the population by a regulated process of decision-making, which the claimants accept as their entitlement.

A closed right is a concession which was transmuted into a right by its repetitive grant to the same group of "concessionaires". It is "closed" because it is available only to a certain group and unavailable to others.

An open right is a concession which was transmuted into a right by its repetitive grant to an enlarged group of "concessionaires".

It is an "open right" because it is no longer exclusive to the original "concessionaires" and has become available to others.

A concession turns into a right because its repetition induces expectations for its recurrence, so that the former privilege becomes an awaited and demanded right. At this stage, the reasons and motives which prompted the original concessions become obscured by more recent events.

Professor Schmitthoff pointed out that the reasons that prompted

the **Companies Act** to grant these concessions to small businesses were their unimportance and the possible burden on the administration.[174] But despite the Act's practical considerations, it created a group which enjoyed exemptions from obligations vis-à-vis another group which was burdened with them.

The fact that a group enjoys a certain exemption is not in itself sufficient to create a new class of defineds. But the repetition of that exemption to the same recipients produces a group which is being habitually privileged with "closed rights" that are unavailable to others. This differentiates this group sufficiently for it to merit a separate definition.

The **Companies Act 1967** granted small businesses concessions by exemptions. According to the preceding argument, these concessions create a small business definition on the following counts:

1. A "concessionaire" has to identify himself before he can become one. This he does by complying with the Act's conditions. His definition is therefore the satisfaction of the Act's requirements of 100 employees,[175] or of £25,000 turnover,[176] or of £15,000 emoluments,[177] or of a £2000 loan.[178]
2. The repetitiveness of the concession has granted the "concessionaire" a "closed right", the exclusive ownership of which sets him apart from those who are deprived of it, and entitles him to

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174 Ibid.

175 Companies Act 1967, Sec.18(5).

176 Companies Act 1967, Sched.8, Par.13A, 'Turnover'.

177 Companies Act 1967, Sec.8.

178 Companies Act 1948, Sec.197.

his own definition which is provided by the Act.[179]

By these exemptions, the **Companies Act 1967** has created a separate group entitled to its own definition. Whether by doing so it has also defined small business, or merely defined an exempted group, depends on the qualitative value and the quantification of each exemption, the evaluation of which is discretionary and depends on the evaluator.

The 100 employee and or the £250,000 turnover criteria might reasonably have been intended as components of the small business definition. But that the £15,000 emolument and the £2000 loan criteria were intended as such is unacceptable for practical discretionary reasons.

(b.3) The Sex Discrimination Act 1975 (Discrimination in the Employment Field)

The **Sex Discrimination Act** has exempted employers with a maximum of five employees from its jurisdiction.[180] This low numerical threshold could not have been intended as the differentiator between large and small enterprises, but rather as the division between businesses and non-businesses. The Act has recognised the fact that such a small employer of five or fewer persons functions in a dual capacity; that of an employer and that of an individual. As an employer, he has to abide by the duty of non-discrimination towards employees. But as an individual he has the right to choose his close associates, be they male or female.

That the Act has intervened in favour of his function as an individual indicates that the exemption was not granted to the small business as such, but to the owner as an individual.

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179 As detailed in the preceding paragraph 1.

180 Sec.6(3)(b).

(b.4) The Industrial Training Act 1964 – Industrial Training Levy Orders

The **Industrial Training Levy Orders** are a group of administrative regulations issued separately by each of the existing Industrial Training Boards, and approved by the Manpower Services Commission in accordance with Section 7 of the **Industrial Training Act 1964**[181] and the Secretary of State.[182] Section 7(1A)(a) of the Act[183] exempted from the levy employers with small numbers of employees.

The actual numerical threshold determining the exemption is decided by each Board separately, in accordance with the characteristics of the industry it represents, and the guide-line of Sec.7(1A)(a) of the 1964 Act. At intervals of approximately 9 months, the Boards issue Orders stating the percentage of levy to be imposed on the companies' payrolls and the conditions for exemption.

The Boards have been using two criteria to determine the exemptions - number of employees and payroll. Although Sec.7(1A)(a) of the 1964 Act states that the exemption is "in view of the small number of employees" and does not mention another criterion, Sec.7(1A) of the Act allows the number of employees to be determined by reference to such factors as are specified in the Board's proposals. The payroll criterion has been introduced through the latter part of Sec.7(IA).

Several explanations were forwarded by the representatives of the various Boards for the use of different criteria and determinants for the definition of "small numbers of employees". The most common one

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181 The Industrial Training Act 1964 was amended by the Employment and Training Act 1973.

182 Under Section 7(IC) of the 1964 Act as inserted by the 1973 Act.

183 As confirmed by the Employment and Training Act, 1973, Sec.5(1)(2A)(b), Sched.2.

was that the chosen criterion was the most suited for that industry.[184] And although such decisions were in accordance with the Board's discretionary rights under the Act, deeper probings have revealed other reasons. It was argued that the payroll criterion suited industries with a chronic fluctuation in the number of their employees, due to seasonality and/or market fluctuations, because it is easier to ascertain than the actual numbers of employees.[185] Elsewhere the employment criterion was favoured because the payroll of the skilled and highly paid employees of certain industries, used in comparison with the lower payroll of other industries, will not result in an accurate reflection of the numbers employed.[186] It is difficult to substantiate any of these explanations, but it has been observed that the Boards themselves have not been consistent, either with the criteria they used or with the thresholds they fixed. In July 1977, out of 23 Boards, seven used an employment criterion only, 12 a payroll criterion only, three allowed the use of either and one Board had no exemptions at all.[187]

In 1971,[188] out of the same 23 Boards, only four had used an employment criterion and all the remaining 19 used the payroll criterion.[189] The trend has been to change from "payroll" criterion to "employment" and to increase the threshold determinants, allowing more employers to benefit from the exemption.[190]

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184 Conversations with representatives of the ceramics, glass and mineral products Board, the air transport and travel Board, printing and publishing Board, and the road transport Board.

185 An opinion expressed by the printing and publishing Board representative.

186 Supra, note 184.

187 See Appendix No.1.

188 J.E. Bolton, Small Firms: Report of the Committee of Inquiry on Small Firms, HMSO, 1971, pp.250-252.

189 Comparison of the 1971 exemption thresholds to those of July 1979, see Appendix No.1.

190 Ibid.

Although the Boards try to rationalise their choice of criteria as the most suitable ones for their respective industries, it is difficult to find a supporting rationale, and therefore one must conclude that such a choice is arbitrary. As to the exemption thresholds, here the Boards were definitely biased against excessive exemptions, as these affect their own income from the industry. This is therefore not a case of neutral arbitrariness, which is neither "for" or "against", but a case of bias against the exempted, which is written into the law itself. The Act allows the Boards, whose influence and power depend on the monies collected from the levied businesses, to determine the numbers of the exempted small businesses, with the full knowledge that every one exempted reduces the Boards' income.

The Bolton report shed some light on the Boards' considerations in determining the size of a small business:

> "Some training boards would suffer financially from the exemption of small firms; though their administrative expenses would be substantially reduced, the loss of levy income would considerably exceed this saving ...The effects on boards with a higher proportion of small firms would however be more drastic, and they might be obliged to curtail their activities."[191]

When the decision to exempt small businesses depends on the deciders' self-perpetuation instincts, it is no wonder that the sizes considered by the training boards to be small are very small indeed. The largest "small" business is found in the engineering industry with 60 employees; the next in the transport, carpet, and rubber and plastic industries with 26 employees each; in the wool, jute and flax industries 25 are allowed; in knitting and lace 24;and in furniture 15. For the distributive industry, which has the highest concentration of small businesses, a threshold of 10 employees was the determinant.[192]

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191 Bolton, p.248, supra, note 188, p.276.

192 See Appendix I.

The fact that all the upper thresholds determined by the Industrial Training Boards are much lower than the 200-employee upper threshold of the Bolton Committee, and most are lower than the 50-employee upper threshold of the **Inner Urban Areas Act 1978**, accentuates the subjectiveness with which the Boards have used the threshold determinant. A definition depends on the definer's perception of the defined, and not on the defined's about himself, or anyone else's about him.[193] And because of this, it is not correct that the legislator should allow those who benefit from a decision to be also those who take it.

There is no doubt that when threshold determinants are left to administrative discretion, they can be manipulated to suit interested parties, as seen with the Industrial Training Boards. To manipulate the choice of the criteria is more complicated than to manipulate their numerical determinants, however, and therefore it can be accepted that the choice of the criteria is fundamentally of a neutral arbitrary nature and not a biased one.

It is self-evident that the employment criterion with its attached thresholds, as used by the Industrial Training Boards, is not a small business definition. Though the legislator might have intended it to be one, the administrators have introduced their own considerations, and have steered the legislator's aim to suit their own ends. This fits in with the pattern of the definer's and the applicator's behaviour, by which the role of the definer ceases with the emergence of the definition, while the role of the applicator (the administrator in this case) is continuous.[194]

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193 See pp. 53,54.

194 See pp. 55,56.

(c) The UK Small Business Definition According to the Exclusive Method of Definition by Exclusion

Legislation that uses the exclusive method of definition by exclusion concerns itself only with those within its jurisdiction, and therefore defines only them. The assertion that it might also define small businesses is based on the argument that the included, by their inclusion, define also the excluded.

(c.1) The Disabled Persons (Employment) Acts 1944 and 1958

The **Disabled Persons (Employment) Acts 1944** and **1958** imposed a statutory duty on all the employers of 20 employees or more to employ a percentage, currently 3%, of registered disabled persons. It would seem that by excluding small employers from the Act's jurisdiction, they were granted a privilege which was withheld from others, namely, they were not expected to employ disabled persons.

In order to decide whether this exclusion was intended as a small business definition, it is necessary to find out whether the legislator meant it to benefit the small employers; or whether the exclusion was intended to safeguard the well-being of the disabled persons.

The law deals with the rehabilitation of disabled persons, whom, without coercion, employers were not volunteering to employ. Yet a resentful (and probably personally present) employer was not going to help the integration of the disabled. Having the disabled's well-being in mind, the Act did not enforce the duty to employ them on small employers.

In this Act, the employment criterion was not introduced as a measurement of economic viability, but rather as a gauge of a social environment. Therefore it would seem that the exclusion of the small employer was not because of his financial inability to engage an unproductive disabled employee, but as a consideration of the disabled person's well-being. This exclusion cannot therefore be construed as the legislator's intention to define a small business.

(c.2) The Factories Act 1961

The **Factories Act 1961** used the employment criteria of 50 employees as the inclusion threshold of Section 61 that required the presence of a trained first-aid person on premises with that number of employees. This lower threshold of inclusion acts as an automatic upper threshold for exclusion from the jurisdiction of Section 61.

The excluded from Section 61 cannot be considered as having been defined as small businesses because of two reasons; their exclusion was only from one section of the Act, and the exclusion did not have the benefit of the excluded in mind, but that of the included.

(c.3) The Offices, Shops and Railway Premises Act 1963 (National Insurance Industrial Injuries) (Claims and Payments) Regulations 1964

These regulations applied only to the employer of more than 10 employees, who was required to keep an accident book, which means that the employer of less than 10 employees was excluded. Although this exclusion can be seen as a concession to small businesses, whose difficulties with paperwork requirements are known, there does not seem to be a conflict of interest between the supposed benefit to the employee and the concession to the employer, since in a small workplace the details of an accident can be easily ascertained verbally. Thus the employee does not lose, and the employer gains.

Alhough exemptions from paperwork requirements are welcomed by small businesses, irrespective of their suitability as a small business definition, the fact that the present exemption is of a trivial nature precludes it from being considered as a small business definition.

(c.4) The Fire Precautions (Factories, Offices, Shops and Railway Premises) Order 1976

The **Fire Precautions (Factories, Offices, Shops and**

Railway Premises) Order 1976[195] stipulated that a fire certificate is required for any factory, office or shop premises in which persons are required to work and:

(i) more than 20 persons are employed at any one time, or

(ii) more than 10 persons are employed at any one time elsewhere than on the ground floor; or

(iii) which is in the same building as another factory, office or shop premises and the same total of employees working in all those premises at any one time exceeds 20 or exceeds 10 elsewhere than on the ground floor.

This order uses the employment criterion only as a means to define its own aims and jurisdiction, and therefore does not define small business.

(d) Summation

The use of the different methods of definition by the UK legislation that relied on the employment criterion indicates the existence of a pattern in which the aims of the legislator determined the methods of definition used.

In two[196] of the legislative acts that used the employment criterion according to the positive method of definition, the small businesses were bestowed with benefits of actual financial grants; and in the third[197] their conformity with the definition resulted in a whole set of concessions as to accounting and disclosure procedure, in contrast to the isolated concessions of similar measures.[198] From this it would seem that the positive method of definition is undertaken with the clear aim of

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195 As authorised by the Health and Safety at Work Act 1974.

196 The Inner Urban Areas Act 1978 and The Employment Subsidies Act 1978.

197 Company Accounting and Disclosure, A Consultative Document, 1979.

198 The Companies Act 1967 Sec.18(5) exempted only from one disclosure duty.

benefiting the defined.

The exclusive method of definition by exemption was used by legislations that aimed at benefiting the employers, without harming the employees; while the legislation that used the exclusive method of definition by exclusion was directed at securing the interests of the employees. Although a pattern has emerged regarding the use of the methods of definition, there does not seem to exist any pattern in the use of the numerical determinants, which varied from five[199] to 200[200] employees.

(iv) The Employment Criterion in the Legislation of Israel

In contrast with the other countries of the research, Israel has not joined the trend of promoting small businesses. This can be explained in two ways. One explanation is that because most businesses in Israel are small, a small business as such is not an extraordinary phenomenon which merits special attention or legislation, while the other is based on the ideology of the State's founders, who envisaged a socialist, non-capitalist Jewish state, and for whom any concessions to private enterprise were made out of realistic necessity rather than ideological conviction. Thus, if they could not prevent their existence, they could at least refrain from promoting them; and this they have succeeded in doing.

When economic reality dictated the need for private enterprise, the State chose to encourage and assist only the big businesses. It seems that fully-pledged socialists find it easier to reconcile themselves to the

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199 The Sex Discrimination Act 1975.

200 The Employment Subsidies Act 1978.

existence of big private enterprises than of small ones.[201] This may well be because in the small business they can identify the despised concept of the capitalist with the single owner, the small businessman; while in the big business the ownership is more abstract and diffused and can be equated more easily with the concept of public ownership to which they are more attuned. Socialists tend to excuse private big business on account of its efficiency, progresssiveness, modern management techniques and centralisation, all of which are concepts postulated by socialist doctrine and therefore understood by its disciples, while the small business with its capitalist owner, represents all that socialism opposes.

A more simplistic explanation and most probably also a more correct one is that because of Israel's continuous security and economic problems, the promotion and/or definition of small businesses was not seen as a pressing issue that needed attention. Yet despite this, it is interesting to note that the Israeli legislation used the employment criterion, with low numerical determinants for the purpose of defining enterprises with fewer or less arduous obligations than others. Whether this was meant as a small business definition will have to be ascertained separately for each legislation. The legislations that used the employment criterion are found in three branches of the law - Taxation, Labour and Economics - each of which will be dealt with separately.

(a) Employment Criterion in Israeli Taxation Laws

Usually one would expect to encounter the use of an employment criterion in the branch of law dealing with labour, and to a lesser extent also in economic law, owing to the natural affinity between labour and employment, and the state of the economy - but not in the law of

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201 Adolf A. Berle, Gardiner C. Means, The Modern Corporation and Private Property, Harcourt, Brace and World, Inc., New York, 1968, pp.viii, ix.

taxation. Although in all instances the employment criterion served to define the "size" of an enterprise, which was subsequently correlated to a duty or an exemption from it, the apparent lack of cohesion between the subject of the legislation and its criterion, as in the laws of taxation, is an anomaly requiring closer investigation.

Because the laws of taxation are primarily concerned with the collections of revenues, which are usually derived from taxation levied on the turnover, profit or payroll of an enterprise, it is logical to expect that the same criteria that attract the specific tax in the first instance would also be used to define those included within its jurisdiction, or those excluded from it. The expected identity between the subject of the law and the criteria it uses does not extend to their numerical determinants, since the task of the latter is to vary with the change of the legislator's aims. For example, in the case of an income tax law, which is levied on an income or a profit, a reduction in the rate of taxation or a total exemption from it should be related to the same criterion of income or profit, but the threshold determinant should differ to suit the individual situations.

It would be a valid assertion that customarily an employment criterion is rarely encountered in taxation-related legislation unless the subject of the taxation is employment. It would be natural for a tax levied on numbers employed to correlate the size of the enterprise with the number of its employees and consequently with its taxation dues,[202] but Israeli tax legislation[203] also uses the employment criterion in connection with Income and Value Added taxes which are levied on profit

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202 The UK Selective Employment Tax, which has been abolished, was based on the number of employees.

203 Income Tax Instructions (Book-Keeping)(No.2) 1973 (5733). Value Added Tax Law 1975 (5736). Israeli legislation is dated according to both the Jewish (in brackets) and the civil calendar.

and turnover, and not on the number of employees. The use of the employment criterion by the **Income Tax Instructions** could be justified on account of the specific subject-matter of the regulations - book-keeping - which has some connection with the number of employees, since the more detailed the book-keeping is required to be, the more manpower it involves. Bearing in mind the practical aspects of tax collection, the legislator might have correlated the number of employees and with the strictness of book-keeping requirements, and allowed those with fewer employees a simpler book-keeping system.

A similar consideration could have also influenced the Value Added Tax legislator when he used the employment criterion in the definition of the "small trader" - namely a relation between manpower and paperwork requirements. In this case the exemptions did not relate to book-keeping, as these were covered by the **Income Tax Instructions (Book-keeping)** requirements, but regarded matters of registration and reporting.

(a.1) Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)[204]

The maintenance of proper account books has been a vexed and much discussed issue for the Israeli business population and the tax authorities. The origins of the controversy can be traced to the early years of the State, when a high proportion of the business population lacked knowledge of the Hebrew language and modern business techniques. The pressing needs of a young country to build up its economy took preference over the need to have a meticulous management of such an economy. One of the most pressing needs of the country was the collection of revenue, which could not wait for the affirmation of book-keeping records and their verification. The authorities therefore resorted to a system of assessments, bargaining and compromises, for lack

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204 QT 2958, 1973 (5733) (Jan. 2, 1973), p.626.

of evidence on the part of the taxed and the collectors alike. This practice of running enterprises without adequate bookkeeping control reached an epidemic scale, and reduced the relationship between the tax authorities and the population to mutual distrust, whereby the tax authorities rejected any books as false, and the citizens suspected them as biased and corruptible.

It was felt that unless a strict adherence to accurate and correct book-keeping administration was introduced, the State would develop on the pattern of a Levantine country, where negotiations between officials and citizens are conducted on the personal level, and not according to the law. By the 1970s, the need to introduce such legislation was felt to be urgent. But at the same time it was argued that the introduction of the population to these book-keeping requirements ought to be gradual.

When referring to the **Income Tax Instructions (Book-keeping)**, the historical background of their promulgation ought to be kept in mind.

(a.1)a. Application

The duty to keep an appropriate set of books has been imposed by Section 2(a) of the **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733) (as amended)**, on every trader whose turnover exceeded the sum fixed by Sections 31(3) and 126(a) of the **Value Added Tax Law 1975 (5736).**[205] This instruction links the book-keeping requirements of the Income Tax authorities with those of the Value Added Tax authorities. This means that the same exempting turnover determinants apply to both taxes.

The **Income Tax Instructions (Book-keeping)** have tailor-

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205 SH 791, 1976 (5736) (Jan. 6, 1976), p.52.

made their book-keeping requirements for the different sectors of the tax-liable populace, and related them to the trader's occupation and size, rather than to the legal form of the enterprise.[206] In other words, the duty is attracted by the contents and not by the form.[207] For the purpose of book-keeping, taxable traders are divided into 16 different occupational categories, within which they are sub-categorised according to sizes. The book-keeping requirements are related to the size of each sub-category, and the smaller-sized enterprises are allowed simplified procedures. The size of the enterprises has been decided according to various criteria, of which turnover and employment are the most often used, though others such as number of pupils for schools or litres of petrol for petrol stations, are also employed for size definition.

The employment criterion is employed by seven out of the 16 supplements of the **Income Tax Instructions (Book-keeping)** by:

Supplement One - Book-keeping by Manufacturers

Supplement Two - Book-keeping by Wholesalers

Supplement Three - Book-keeping by Retailers

Supplement Four - Book-keeping by Building Contractors

Supplement Nine - Book-keeping by Land Merchants and Middlemen

Supplement Eleven - Book-keeping by the Service Sector

Supplement Thirteen - Book-keeping by Other Trades

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206 By "legal form" is meant forms of trading, such as partnership, private, limited, or public companies.

207 In the UK, for instance, the Income Tax authorities do not require from the unincorporated trader the same standard of bookkeeping as they do from a registered company. Whereas the former is expected to keep "adequate" books, the latter is bound to keep a detailed system. Also the EEC Fourth Directive on Company Accounting and Disclosure relates the comprehensiveness of accounting to the legal form of the company, and distinguishes between a private and a public company.

The employment criterion is not used as an exclusive determinant,[208] but always in conjunction with the turnover criterion, except for two occasions, when it is used as an "alternative" to the turnover criterion.[209]

The Supplements follow the same structural pattern, they divide the sector into sub-groups according to different criteria and allot each sub-group its appropriate set of book-keeping requirements.

(a.1)b. Supplement One – Book-keeping by Manufacturers

Supplement One of the Instructions, which enumerates the book-keeping requirements of the manufacturing sector, differentiates the latter into six size groups, of which three are determined exclusively by a turnover criterion and three by joint turnover and employment criteria.[210]

The three groups whose sizes were determined by both criteria are defined as follows:

The first group[211] is defined as having a turnover of less than IL4,000,000 p.a. and a minimum number of 18 employees.

The second group[212] is defined as having a turnover of less than IL1,200,000 p.a.and between 6-17 employees.

The third group[213] is defined as having a turnover of less than IL1,200,000 p.a. and fewer than 6 employees.

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208 In Supplement Nine of the Income Tax Instructions (Book-keeping) Sec.4(b), the employment criterion is used as an exclusive criterion for a specific paperwork requirement, but not as a definer of a "size".

209 The employment criterion is used as an alternative to the turnover criterion in Supplement Two of the Income Tax Instructions (Book-keeping) Sec.2(a), and in Supplement Three Sec.2(a).

210 The latter parts of Supplement One, Secs.2(b), 2(c) and 2(d).

211 The latter part of Supplement One, Sec.2(b). Note: In October 1980 the rate of the Israeli lira was IL160 to the £ sterling. Or 16 shekalim according to the new Israeli currency which was introduced at the beginning of October 1980 (shekel = singular, shekalim = plural).

212 The latter part of Supplement One, Sec.2(c).

213 Supplement One, Sec.2(d).

As to why these three groups are defined according to both criteria while the others are defined only according to the turnover criterion, is not known. If, for example, the employment criterion had been used systematically as an additional criterion for the definition of the smallest "size" groups, it might have been possible to suggest that because detailed book-keeping requires additional manpower which the smallest enterprises lacked, the legislator has reduced their book-keeping requirements. But since this is not in fact so, as the legislator has not used the employment criterion consistently, such a suggestion has to be dismissed.

A different explanation might be that as a result of the heavy taxation of the Israeli population, it is assumed, rightly or wrongly, that tax avoidance and evasion are a chronic syndrome there. Hence the tax authorities have introduced the employment criterion to act as an additional safeguard aimed at ascertaining that those intended to be included within the catchment area of a certain "size" group do not manage to exclude themselves from it, and relegate themselves to a less demanding category.

Usually it might be expected that if a sector was divided for the purpose of book-keeping into four sub-groups, each sub-group would be allocated a different set of book-keeping requirements; but the **Income Tax Instructions (Book-keeping)** have not adopted this method. In the presently dealt with Supplement One[214] the sector is divided into six different-sized sub-groups, but the book-keeping requirements only into four sets. This meant that two different sub-groups[215] may be confronted with the same set of book-keeping requirements. For example, the set of book-keeping requirements enumerated in Sec.2(b),

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214 The Income Tax Instructions (Book-keeping) No.2, 1973 (5733) (as amended).

215 Supplement One, Sec.2(a) and Sec.2(d).

consisting of eight specific requirements, is imposed on two different groups, one group with a turnover criterion of IL4,000,000-IL10,000,000, and another with a turnover criterion of below IL4,000,000 and an employment criterion of more than 18 employees. These are two entirely different defineds, yet both are confronted with the same set of book-keeping requirements.

The complexity of the regulations imposed on a manufacturer by Supplement One is demonstrated in the following table:

Sets of book-keeping requirements, listed in decreasing order of rigorousness	No. of applicable defineds	Definition (figures in millions of IL)	Criteria
Set "A" (Sec.2(a)) (most rigorous)	1	Turnover over 10m	Turnover
Set "B" (Sec.2(b))	2	a.Turnover 4m-10m	Turnover
		b.Turnover under 4m and 18 or more employees	Turnover and employment
Set "C" (Sec.2(c))	2	a.Turnover 1.2m-4m	Turnover
		b.Turnover under 1.2m and 6-17 employees	Turnover and employment
Set "D" (Sec.2(d)) (least rigorous)	1	Turnover under 1.2m and fewer than 6 employees	Turnover and employment

It can be seen that in Sections 2(b) and 2(c), the introduction of the employment criterion coincides with a widening of the catchment area of each of the two sets of book-keeping regulations in order to pull in certain traders who would otherwise have been in a lower, easier set. Set "B" includes some traders who without the employment criterion would have been included in the less demanding Set "C", and Set "C" some who would otherwise have belonged to Set "D". This reinforces the

assertion that the legislator was primarily concerned with the increase of revenue, and not with the definition of small business.

From the point of view of those defined, the definer's motivations are irrelevant, for it is the final regulations with which they are confronted, and by which they have to abide, regardless of the legislator's considerations or reasons. But from the standpoint of a researcher, attempting to ascertain whether the legislator used the employment criterion for the sake of defining the size of a business (and in particular that of a small business), or whether he used it only in order to increase the revenue of the Income Tax authorities, the definer's motivations are of the utmost importance.

If the former intention is accepted as the one which motivated the legislator, then it could be concluded that for the purpose of book-keeping procedures the Israeli Income Tax authorities considered a small business to be one that employed fewer than 6 employees, or at the most one which employed up to 18 employees.[216] But if the latter intention is believed to be the one held by the legislator, then it must be concluded that the use of the employment criterion in the definition of an enterprise's size was not intended to define the "size" of a business as such, but was used as a measure to include the largest possible numbers of defineds within a tax-paying category.

(a.1)c. Supplement Two – Book-keeping by Wholesalers

As already mentioned[217] the **Income Tax Instructions (Book-keeping) No.2, 1973 (5733)** have divided the tax-paying population into 16 categories, within each of which they distinguished different defineds.

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216 This is because according to Sec.2(b) the employment criterion is over 18 employees, "over" meaning an indefinite number of employees.

217 See p.287.

The book-keeping requirements for the wholesaling sector are different from those of the manufacturing sector, in the numbers of different book-keeping sets and in their contents. Also the number of defineds is dissimilar; in the manufacturing sector there are six defineds, but in the wholesaling only five. Out of these five defineds, two are defined exclusively by the criterion of turnover, one alternatively by turnover or employment and the other two by both criteria.

Supplement Two uses the employment criterion in the following instances:

1. in Sec.2(a) for the alternative definition of a wholesaler who employs six or more employees;
2. in the latter part of Sec.2(b) for the definition of a wholesaler who employs four or five employees and has a turnover of less than IL2,500,000; and
3. in Sec.2(c) for the definition of a wholesaler who employs a maximum of three employees and has a turnover not exceeding IL2,500,000.

Supplement Two, like Supplement One, does not use the employment criterion as an exclusive criterion for the definition of a size of a business, but uses it in conjunction with the turnover criterion.

(a.1)d. Supplement Three – Book-keeping by Retailers

Within the jurisdiction of Supplement Three are included five groups of defineds, which are matched with two sets of book-keeping requirements; one set applies to two of the defineds,[218] and the other set to the remaining three.[219] This is the highest number of different defineds that is attached to any one set of book-keeping instructions.

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218 Supplement Three, Sec.2(a).

219 Supplement Three, Sec.2(b).

Of the five defined groups of retailers, one is defined exclusively by the employment criterion, three by a combination of employment and turnover criteria, and one exclusively by the latter. An employment determinant of seven employees or more is used by Sec.2(a), of five or six employees by Sec.2(b), and of a maximum of six also by Sec.2(b).

The structure of Supplement Three is as follows:

Set of book-keeping requirements, listed in decreasing order of rigorousness	No. of defineds	Definition (figures in million of IL)	Criteria
Set "A" (Sec.2(a)) (more rigorous)	2	a.Turnover over 4m b.7 or more employees	Turnover Employment
Set "B" (Sec.2(b)) (less rigorous)	3	a.Turnover 2m-4m b.Turnover under 2m and 5 or 6 employees c.Turnover 2m-4m and fewer than 7 employees	Turnover Turnover and Employment Turnover and Employment Specific traders: applies to jewellers, perfumery, pharmacy, opticians

When the unsystematic use of criteria and thresholds was encountered in Supplement One, an attempt was made to find some sort of rationale, or a plausible reason for the division of that sector into its various defineds. When the same lack of system was encountered in Supplement Two, it was almost accepted as a "system" on account of its being persistently unsystematic. But after studying Supplement Three, any attempt to find a reason for a specific use of a criterion, and/or its threshold determinants, for the definition of the various defineds in the retail sector, is being abandoned, since it becomes apparent that the

initial cynical proposition[220] that the employment criterion was introduced merely as an additional safeguard against tax evasion seems to be a valid one. How else can one explain the reason for such a haphazard mode of definitions, in which under the same requirements are lumped together retail businesses with turnovers of IL2,000,000-IL4,000,000, with others that have less than IL2,000,000 turnover and who employ five or six employees; or with jewellers, pharmacists and opticians who employ less than seven employees and have a turnover of between IL2,000,000-4,000,000?

From these observations one can only conclude that in no way can it be inferred or suggested that the legislator had intended or attempted to define small businesses.

(a.1)e. Supplement Four - Book-keeping by Building Contractors

Supplement Four has three sets of book-keeping requirements for the building sector, and divides the sector into four groups. The employment criterion is used in the definition of two groups. In Sec.2(b) it is used as a lower threshold of six employees, and in Sec.2(c) as an upper threshold of five employees. In both these sections it is not used independently, but supplements the turnover criterion, which has the same upper threshold determinant of less than IL1,000,000 in both cases. Although the two groups have the same turnover thresholds, one of them, because it employs more employees than the other, is confronted with more demanding book-keeping requirements. This might indicate that for the purpose of book-keeping requirements, the legislator considered the employment criterion a more suitable indicator of size than the turnover

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220 See pp.290,291.

criterion.[221]

This observation could provide further help for the understanding of the seemingly irrelevant use of an employment criterion for the definition of a group liable to Income Tax demands, instead of the expected financial criteria that are normally associated with taxation legislation.

Although taxation is related to financial factors, the specific technicalities of book-keeping administration are relevant to the number of employees, as it is they who are supposed to carry out the law's instructions.

(a.1)f. Supplement Nine – Bookkeeping by Land Merchants and Middlemen

Supplement Nine, unlike the other Supplements, does not divide its sector into different sub-groups and imposes the same book-keeping requirements on the complete sector of land merchants and middlemen, regardless of their turnover or number of employees. This is most probably due to the fact that in the Israeli economic climate, this sector is made up mostly of individual enterpreneurs.

Only in one respect is the land middleman with fewer than three employees[222] treated favourably in comparison with the larger one with more employees. This is an exemption from the obligation to enter in the "transaction book" certain details of every "proposed transaction" within three days after the proposal has been made. The exemption is an implied one, since Sec.4(b) does not enumerate the exemption and the exempted, but defines the obliged and their obligations.

Sec.2(3) imposes a duty on every land middleman, regardless of size, to keep a "transaction book", and Sec.4(a) enumerates the details

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221 A similar attitude is displayed by the legislator in Supplements One, Two, Four, Eleven and Thirteen, where the two smallest groups have the same turnover determinant but a different employment one.

222 Supplement Nine, Sec.4(b).

to be entered in the transaction book, while Sec.4(b) requires the employer of more than three employees to enter also details of a "proposed transaction" and not only of a "transaction". The small employer is implicitly exempted from this obligation.

(a.1)g. Supplement Eleven – Book-keeping by the Service Sector

This Supplement establishes three different sets of book-keeping requirements for the whole sector, and divides the sector into five groups according to their particular industries: the letting of halls for social occasions; hotels; transport contractors; garages; and car hire firms.[223] Each of these five industries is then divided into four sub-groups which have to abide by one of the three sets of book-keeping requirements.

Two of the four sub-groups are defined by an employment criterion, in addition to an identical turnover criterion of less than IL10,000,000. The difference between these sub-groups is in their number of employees. The one that is defined by Sec.2(b) has more than five employees, and that defined by Sec.2(c) less than five employees; the latter has to comply with a less stringent set of book-keeping requirements.

(a.1)h. Supplement Thirteen – Book-keeping by Other Traders

This Supplement distinguishes between five types of traders, three "other traders" and two "single traders". The "other traders" are defined by Sec.1 as: "any taxable person who manages a business, or a trade, and who is not included in any of the other supplements", and their sizes are classified by Sections 2(a) and 2(b).

The first group of "other traders" is defined as: "a trader whose turnover exceeds IL1,000,000."[224] The second group is defined as "a trader

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223 Supplement Eleven, Sec.3.

224 Supplement Thirteen, Sec.2(a).

whose turnover does not exceed IL1,000,000 and who employs three or more persons";[225] and the third group is defined as "a trader whose turnover does not exceed IL1,000,000 and who does not employ more than 2 employees."[226] Out of the three "other traders" the third group is allotted the simplest bookkeeping requirements.

The "single traders" are defined by Sections 1(a) and 1(b). The "single trader" of Section 1(a) is defined as an "other trader" in whose business he himself and one member of his family are employed, and whose turnover does not exceed IL500,000; and the "single trader" of Section 1(b) as an "other trader" in whose business are employed he himself or he and one assistant, and whose turnover does not exceed IL900,000.

In addition to the above definition, the "single trader" of Section 1(b) is required to conform to one of the following three descriptions:

1. His place of business is not permanent, and he and his stock are carried around in a non-motorised vehicle.[227]
2. He sells his merchandise on a stall or in an open place.[228]
3. He sells his wares in a small building whose area does not enable the installation of a cash register; but if his main income is derived from the sale of grocery products, vegetables and fruit, the building may be of any size.[229]

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225 Ibid.

226 Supplement Thirteen, Sec.2(b).

227 Supplement 13, Sec.1(b)(1). This would include a pedlar with a horse and cart, a stall owner whose stall has wheels and is moveable, and so on.

228 Supplement Thirteen, Sec.1(b)(2).

229 Supplement Thirteen, Sec.1(b)(3).

The employment criterion is used for the definition of the "single traders" and for the definition of two out of the three groups of the "other trader". In all these instances, the employment criterion is used in conjunction with the turnover one, and in the definition of the "single trader" in Section 1(b) it is accompanied by other criteria as well. The dual classification of the "single trader" according to additional criteria besides employment and turnover seems an unnecessary additional complication to the already complicated labyrinth of Israeli book-keeping requirements. It could, however, be explained in the light of the small size of the Israeli economy, the large number of "single traders", and the common practice of tax evasion, which is a result of the fact that the Israeli population is one of the highest, if not the highest, taxed people in the world.

Had the family relationship been the only difference between the "single trader" of Section 1(a) and the one of Section 1(b), it might have been possible to justify the higher turnover threshold which was allocated to the latter as an expression of distrust by the Income Tax authorities towards the small family business, in which tax evasion is more likely to go undetected for lack of independent witnesses or corroboration. But family kinship is not the only difference between the two "single traders", because the one defined by Section 1(b) also has to conform with one of the requirements of Sections 1(b)(1), 1(b)(2), and 1(b)(3). These additional conditions, which were imposed only on the non-family "single trader" override any speculation as to the authorities' bias against the small family enterprise.

The specific criteria used for the definition of the "single trader" must have been influenced by the tax authorities' experience in their everyday handling of the "single trader", rather than by some profound economic reason. The fact is that the employment criterion,

in its hitherto encountered form of a quantitative factor, cannot be considered to have had a formative influence on the definition of the small "single trader".

(a.1)i. Summation

The Income Tax Instructions (Book-keeping) (No.2) 1973 (5733) use the employment criterion in the definition of taxable groups within seven out of the 16 sectors into which the economy was divided. The seven sectors are: manufacturing,[230] wholesale,[231] retail,[232] building,[233] land merchants,[234] the service sector,[235] and others.[236]

Only on two occasions is the employment criterion used as an exclusive definer of the size of an enterprise,[237] and in all the others it is used in conjunction with the turnover criterion. Such a permutation, in which both criteria have to be complied with, has not been employed by the legislation of the UK, the USA, or the People's Republic of China, which have used either the employment criterion or the turnover one for the size definition of a business, but not both simultaneously. The only other legislation that has used the employment criterion as a joint definer, is the EEC Fourth Directive on company law,[238] regarding company accounts and disclosures, which proposes the use of three

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230 Supplement One.

231 Supplement Two.

232 Supplement Three.

233 Supplement Four.

234 Supplement Nine.

235 Supplement Eleven

236 Supplement Thirteen.

237 Supplement Two, Sec.2(a), where a wholesaler is defined by his having more than six employees; and Supplement Three, Sec.2(a), where a retailer is defined by his having more than seven employees.

238 July 1978.

criteria for the size definition of companies. Employment and turnover are two of the proposed criteria, and balance-sheet total the third. Since only two of these criteria have to be complied with, the employment criterion can be used together with either turnover or total assets.[239]

The similarity between the EEC Fourth Directive on accounting and disclosure procedures and the Israeli **Income Tax Instructions (Book-keeping)**,[240] in their manipulation of the criteria used for the definition of each dutiable group, might indicate that the legislator concerned with accounting, whether for the purpose of protecting the public, as in the EEC Directive, or for the sake of correct revenue collection, is primarily concerned with the introduction of a foolproof system of accounting and/or disclosure, and not with establishing what constitutes a small, a medium, or a large enterprise.

As regards the **Income Tax Instructions (Book-keeping)**, they do not use the employment criterion in order to define the size of an enterprise, in the accepted connotation of small, medium and large, because they did not divide any of the sixteen economic sectors into three such groups, but into any number, from two in one sector to six in another.[241]

Although the employment criterion is not used as a definer of small business, there is some evidence to suggest that it is considered a better indicator of smallness than the turnover criterion,

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239 It is proposed to introduce the EEC Fourth Directive on company law into the UK legislation. A consultative document titled Company Accounting and Disclosure was published in September 1979 by HMSO, Cmnd.7654.

240 (No.2) 1973 (5733).

241 Supplement Ten divides the vehicle sales sector into two groups, according to a turnover criterion; and Supplement One divides the manufacturing sector into six groups.

because on numerous occasions the legislator has differentiated between enterprises with the same turnover but with a different number of employees.[242]

The Israeli **Income Tax Instructions (Book-keeping)** are unique, in that they have related the book-keeping requirements to the size of the enterprise, and not to its form of trading.[243] This was done in order to prevent what is known as "tax planning", whereby an enterprise can choose the least rigorous bookkeeping requirements by adopting the legal form of trading which attracts these, and altering it periodically to suit changing legislative requirements.

(a.2) The Value Added Tax Law 1975 (5736)[244]

The **Value Added Tax Law** defines a "small trader" and uses employment as one of the criteria for his definition, the other being that of turnover. The "small trader" of the **Value Added Tax Law** is not to be confused with the "single trader" of the **Income Tax Instructions (Book-keeping)** because, although both have been intended to describe the smallest size of enterprise, they do not share an identical definition.

Section 1 of the **Value Added Tax Law** defines a "small trader" as a trader in whose enterprise(s) are employed not more than two employees, and whose total turnover, from all his enterprises, does not exceed IL1,000,000[245] or a higher sum as determined

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242 Supplement One, Secs.2(c); 2(d).
Supplement Two, Secs.2(b); 2(c).
Supplement Four, Secs.2(b); 2(c).
Supplement Eleven, Secs.2(b); 2(c).

243 Such as partnership, co-operative, limited company or public company.

244 Supra, note 205, p. 286.

245 As amended by the Value Added Tax Regulations (A Trader's Turnover Determination). (Amdt.) 1979 (5739) on Aug. 29, 1979, with a retroactive effect from Aug. 1, 1979. Now 10,000 Shekels.

by the Minister of Finance, or the equivalent sum of money as calculated according to the indexation to the Retail Price Index.[246]

Section 1 also defines employees, and suggests that they include owners, partners or working family members. According to this meaning of "employees", the two employees employed by the "small trader" of the **Value Added Tax Law**, and the owner and one other employee who work for the business of the "single trader" of the **Income Tax Instructions (Book-keeping)** amount to the same number of employees, namely two; but the similarity between the "small" and the "single" trader goes no further than this, for their turnover determinants are different. That of the "small trader" is fixed at IL1,000,000, and that of the "single trader" varies between IL500,000 and IL900,000, depending on whether it is a family enterprise or not.

The reasons for the definition of the "small trader" by the Israeli **Value Added Tax Law** is not clear, because it does not on the whole result in any extra benefits or extra duties to the defined. As the role of definitions is the segregation of the defined from among others so that it can be given different duties or rights, a defined such as the "small trader" whose duties or rights are not changed is an anomaly. For example, in the UK the Value Added Tax has used the criterion of turnover to define a trader who was exempt from having to register himself as liable to the tax, but this is not the case with the Israeli Value Added Tax legislation: the "small trader" is expected to register, and is also expected to submit periodic VAT returns. Certain minor differences do exist, however, between the "small trader" and the normal trader. Different titles are granted on registration, and these attract

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246 Sec.126(a).

different privileges and duties. The "trader" is automatically granted a status of a "registered trader", while the "small trader"[247] receives only a certificate of registration. A particular anomaly of the situation is that the larger "registered trader" is allowed to deduct VAT from all his legitimate business expenses,[248] while the "small trader" may deduct only part of his VAT expenditure.[249]

From the information accumulated so far, it seems that the "small trader" is not only deprived of any privileges, but is also loaded with extra encumbrances that are not imposed on others. The only mitigation in his duties might be found in Section 31(3), which exempts from VAT transactions of a "small trader" whose turnover is less than IL40,000".[250] This exemption from VAT is baffling because "transactions of a small trader whose turnover is less than IL40,000" means all his transactions; not only those which are tax-exempt in their own right, but also others on which the right is conferred by the "small trader's" status. This means that the exemption is really attached to the small turnover and not to the transaction. Yet from the wording of the definition it appears that the determining criterion for the exemption is the "transactions" and not the turnover. It therefore seems that Section 31(3) defines another "small trader", in addition to the one defined by Section 1, namely a "small trader" whose turnover is lower than IL40,000. It is only the latter small trader who is exempted from paying the Value

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247 Sec.53(a), 53(b).

248 Sec.38(a).

249 Sec.42.

250 Sec.31(3).

Added Tax, and not the "small trader" with the IL1,000,000 turnover.[251]

In the light of Section 31(3), it is possible to see the logic of Section 42, which bars the small trader from deducting the VAT from all the business expenses charged to him, restricting the deduction to a portion of the expenses, its size fixed periodically by the Minister of Finance. This is because if Section 42 referred to both "small traders" (the bigger one of Section 1 and the smaller one of Section 31(3), then it could not allow the one of Section 31(3) (with the turnover of IL40,000) to deduct the VAT on all his expenditure, as he would not have paid VAT in the first place. The fact that Section 42 distinguishes between types of "small trader" reinforces the argument that the definition of Section 1 is not an exclusive one, and is encroached upon by the definition of Section 31(3).

It would have been expected that a definition which distinguishes a sub-division of a defined, such as the present one which differentiates between a "trader" and a "small trader", should have also distinguished between their duties and/or privileges to such an extent as to justify their separate definitions; but the Section 1 definition of the "small trader" did not fulfill these expectations, because the "small trader" with a turnover of between IL40,000-IL 1,000,000 did not benefit from any privileges, and might have even lost VAT on his expenses.[252] It is therefore the lower IL40,000 determinant[253] that ought to constitute the turnover criterion of the definition of a "small trader", and not the higher one of IL1,000,000,[254] because it is the lower determinant which attracts the

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251 Sec.1.

252 This is because the percentage or amount of allowable deductions is fixed periodically by the authorities.

253 Sec.31(3).

254 Sec.1.

privileges and not the higher. Further support to the assertion that the definition of a "small trader" is to be found in the combination of the employment criterion of Section 1 with the turnover criterion of Section 31(3), is to be found in the **Value Added Tax Regulation 1976 (5736),**[255] which exempt such small traders, as mentioned in Section 31(3) from the duty to submit a VAT return.[256]

(a.2)a. Summation

The **Value Added Tax Law** defines a "small trader" by using a combination of two criteria, employment and turnover, and owing to their inter-relationship it has been necessary to deal with the turnover criterion at this stage, since without it the definition of the small trader would have become meaningless.

The employment determinant of two employees has been a consistent feature of the **Value Added Tax Law** and its pursuant Regulations, whereas the upper threshold determinants of the turnover criterion differed within the **Value Added Tax Law** itself, and consequently also within its pursuant Regulations. Because the employment criterion seems to be the more stable, and therefore also the more reliable of the two criteria used in the definition of the "small trader", it is possible to say that the total number of two employees is the basis of a small business definition by the **Value Added Tax Law.**

Had the definition relied only on an employment criterion, then the number of two employees would have constituted its definition of a small business; but since the definition depends also on the turnover criterion,

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255 Published QT 3524, 1976 (5736), May 12, 1976, p.1590. as amended by QT 3576 - Aug. 18, 1976; QT 3626 - Dec. 1, 1976; QT 3676 - Mar. 13, 1977; QT 3744, Aug. 1, 1977; QT 3760, Sept. 11, 1977; QT 3785, Nov. 24, 1977; QT 3820, Mar. 1, 1978; QT 3855, June 1, 1978; QT 3911, Nov. 23, 1978; QT 3950, Feb. 27, 1979.

256 Ch.6, Sec.22(2) of the Regulation.

and as its upper threshold is not clear owing to the difference between Section 1 and Section 31(3), a unanimous definition of a small trader does not exist in the **Value Added Tax Law.**

The two definitions of Sections 1 and 31(3) do, however, have a common denominator: the small trader who employs two employees and whose turnover is between IL40,000 and IL1,000,000. Whether from an economic point of view, two employees and such a low turnover determinant are a realistic and meaningful definition of a small business, is dubious. What could, however, be accepted is that this is a juristic definition promulgated for a specific law with a specific task, in the context of a highly idiosyncratic country with its own peculiar size and taxation problems.

(b) The Employment Criterion in the Israeli Labour Laws

Progressive labour laws, committed to the protection and advancement of workers' conditions, are not usually reconcilable with legislation that imposes different duties on different sizes of employers. From the workers' point of view such a differentiation can have only one result: less benefits for those workers whose employers benefit from reduced duties. Therefore, when the employment criterion is encountered in labour-related legislation in a country known to represent the interests of the workers rather than those of the employers, the examination whether the relevant use of the employment criterion constituted, or was intended to constitute, a small business definition, ought to hinge on the resolution of the issue of whether by differentiating between the duties of one employer towards his workers and those of another towards his, the workers have actually suffered a reduction in their benefits or rights. If no such reduction has occurred, then it must be concluded that even if the definition might constitute a small business definition because of its

practical feasibility, it has actually been intended by the legislator to serve as one, in the sense of lightening the duties of the small employers towards their employees.

The employment criterion has been used in 10 Israeli legislative acts that deal with various aspects of the labour law, and which varied in their legislative origins from prime laws to administrative orders. The issues covered by these legislative acts can be categorised into the following sections:

1. Workers' safety conditions at work (seven laws)
2. Workers' sanitation amenities at work (one law)
3. Employers' social responsibility (one law)
4. Industrial relations (one law)

(b.1) Workers' safety at work

Invariably whenever the employment criterion has been used in relation to workers' safety at work, it has dealt with those hazards that could affect larger numbers of employees, like fire, explosions or war, and not with those relating to the safety of the individual worker in the course of the routine execution of his work tasks, such as protective clothing or machine guards.

The seven legislative acts that deal with work safety conditions can be divided into two groups. In the first, the categorisation of the workers according to number is essential for their physical safety; and in the second, the number of employees serves as a determinant for the establishment of administrative measures aimed at establishing safety procedures on the shop floor. The first group is comprised of the following legislation:

1. **Fire-Fighting Services Regulations (Fire Extinguishing Equipment in Industrial Undertakings or Workshops) 1972 (5732).**
2. **Fire-Fighting Services Regulations (Fire Extinguishing Equipment in Hospitals) 1972 (5732).**

3. **The Safety At Work Ordinance (New Version) 1970 (5730).**

4. **The Civil Defence Regulations (Equipment of Industrial Undertakings and Institutions) (Training of Workers) 1973 (5733).**

The second group is made up as follows:

5. **Labour Inspection (Organisation) Law 1954 (5714).**

6. **The National Insurance Regulations (Industrial Injuries Insurance) 1954 (5714).**

7. **Labour Inspection Regulations (Safety Officers) 1965 (5725).**

(b.1)a. Fire-Fighting Services Regulations (Fire-Extinguishing Equipment in Industrial Undertakings or Workshops) 1972 (5732)[257]

Out of the 10 instances of labour-related legislation dealt with in this chapter, the present one is the most important for the purpose of this study, as it is the only one which has actually defined a small business in a positive manner; thus helping to dispense with interpretations and hypotheses as to the legislators' intentions, which are an unavoidable by-product of the exclusive method of definition.

The Supplement to Sections 1 and 2 of the **Fire Fighting Services Regulations (Fire Extinguishing Equipment in Industrial Undertakings or Workshops)**[258] has defined a small, a medium and a large enterprise as follows:

A small industrial undertaking - "an industrial undertaking which employs in the main working shift up to 50 workers".

A medium industrial undertaking - "an industrial undertaking which

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257 QT 2819, Mar. 12, 1972 (5732), p.779.

258 The Fire Fighting Services Regulations (Fire Extinguishing Equipment in Industrial Undertakings or Workshops) 1972 (5732), issued by the Israeli Home Secretary, according to his authority as per Sec.6 of the Fire Fighting Services Act 1959 (5719) and according to Sec.9 of the Business Licensing Law 1968 (5728), and after consultation with the Minister of Agriculture.

employs in the main shift 51-200 workers".

A large industrial undertaking - "an industrial enterprise which employs in the main working shift more than 200 workers".

Since the Regulations concern themselves with safety to man and property, it is not surprising that when determining the quantity and type of fire-extinguishing equipment required for any such premises where people are employed, the number of employees that might have to resort to the use of such equipment was of paramount importance. In addition to the number of employees, these definitions also take into consideration the actual physical size of the premises, by specifying that the number of employees meant the numbers employed in the main shift. The main shift, being the one with the largest number of workers, can be correlated to the actual size of the premises, which would not have been reflected had the determinant related to all the employees who could occupy the premises at different times.

The Regulations do not actually define a small business in the manufacturing sector, because what they specify is simply the largest number of workers likely to be present simultaneously on the premises. Yet the numbers of employees used by the definition of the small industrial undertaking can be accepted as a realistic indication of the numbers that actually constitute a small business, because it is usual for the main shift to include all the clerical and ancillary workers, such as secretaries, store-keepers and drivers, in addition to the shift workers. It could be calculated that the total workforce of a three-shift factory will at the most be double the numbers of its main-shift workers. This means that the definition of 50 workers in the main shift will be doubled to 100 workers for the whole factory, which is a feasible and realistic definition of a small business.

(b.1)b. Fire-Fighting Services Regulations (Fire-Extinguishing Equipment in Hospitals) 1972 (5732)[259]

These Regulations, like the previous ones, derive their authority from Section 6 of the **Fire Fighting Services Law 1959 (5719).** But whereas the former Regulations concentrated on industrial undertakings and workshops, which customarily belong to the private sector of the economy, the present ones deal with hospitals, which are usually associated with the public sector of the economy. Prima facie it might seem that because hospitals in Israel are usually not businesses per se, no definition encountered within the **Fire-Fighting Services Regulations (Fire-Extinguishing Equipment in Hospitals) 1972 (5732)** could be construed as a small business definition, since small businesses are found mostly in the private sector, and hospitals in the public one. However, this is not necessarily so, as hospitals in Israel are not exclusively in public ownership.

There are three types of hospital ownerships in Israel:

1. Ownership by the State.
2. Ownership by the workers' trade unions.
3. Private ownership.

Private ownership is restricted in quantity and size, not by law, but by economic realities, to a few hospitals only, which invariably cater for a specialised segment of the market, and are therefore smaller than most of the hospitals that provide general services. Nevertheless, among the State- and the union-owned hospitals, it is possible to find smaller units. The law, being aware of this, has referred to them accordingly, and the Regulations under consideration here distinguish between small, medium and large hospitals.

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259 QT 2819 - Mar. 12, 1972 (5732), p.770.

Although the hospitals are not specifically referred to as "small", "medium" or "large", this is inferred by the fact that the Supplement to the Regulations was constructed in three parts; Part A had the lowest numerical determinants, Part B the medium, and Part C the highest. All the three categories of hospitals were defined according to two criteria, the number of their employees and the number of the beds they had. The number of beds in a hospital can be compared to the production capacity of an industrial undertaking, and should therefore be considered as a production-related criterion. Part A of the Supplement dealt with hospitals that employed 70 workers or had a capacity of 50 beds; Part B with hospitals that employed between 71 and 400 workers or had a capacity of between 51 and 300 beds, and Part C with hospitals that employed more than 400 workers or had more than 300 beds.

That the regulations have relied on alternative criteria, employment or beds, for the definition of different sizes of hospitals, instead of only on the employment criterion, as was used for defining an industrial undertaking by the **Fire-Fighting Services Regulations (Fire-Extinguishing Equipment in Industrial Undertakings or Work-shops) 1972 (5732)**, indicates the legislators' concern with safety. By using alternative criteria, of which only one, rather than both, is needed to ensure that a hospital falls within a higher category, the Regulations have guaranteed the inclusion of all the hospitals within their jurisdiction.

The distinction made by the Regulations, between a small, a medium and a large hospital, could not however be transferred to the business realm, because it was not undertaken in order to distinguish between their different characteristics, but in order to guarantee the availability of sufficient fire-fighting equipment, according to the size of the hospitals.

(b.1)c. The Safety at Work Ordinance (New Version) 1970 (5730)[260]

The **Safety at Work Ordinance (New Version) 1970 (5730)** deals with various aspects of work safety conditions. It uses the employment criterion only for two aspects of work safety, fire hazards[261] and the administration of first aid.[262] In connection with fire hazards, it is used by Sections 123, 125 and 126, and as regards first aid, it is used by Sections 147 and 148.

Fire Hazards

Section 123 deals with the opening direction of non-sliding doors in case of fire; Section 125 deals with warning by sirens; and Section 126 dealt with evacuation procedures in case of fire.

Section 123(1) requires that the door of a room where more than 10 employees work must open outwards into a staircase or a corridor. Since this regulation deals only with the safety of a small group of workers out of the total workforce, it cannot serve as an indicator of the actual size of the undertaking.

Section 125 fixes the maximum allowable number of employees in an undertaking not equipped with a siren alarm warning system, at 20 workers. This number refers to workers present in one building, and not to the total number of employees. As the restriction of 20 employees applies to a building and not to a firm, it does not constitute a small business definition.

Section 126(1) is similar to Section 125 in that it uses the same

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260 The original version was published in YR 1946, Supplement 1, No.1472, p.60; SH 164 1954 (5714), p.208; SH 382 1963(5723), p.6. The New Version: DMI New Version No.16 Aug. 30, 1970, p.337; Amdt. SH 745, Aug. 23, 1974, p.136.

261 Fire hazards were dealt with by Part C, Safety, Ch.15, Safety Procedures in the Event of Fire.

262 First aid was dealt with by Part D, Workers' Welfare, Ch.5, First Aid.

determinant of 20 employees in relation to a building and not an undertaking, except that it deals with evacuation procedures instead of a siren alarm system.

First Aid

Sections 147 and 148 deals with the contents of a first aid box whose contents are intended to serve 150 workers[263] or part thereof. In an undertaking where more than 50 workers are employed,[264] the first-aid box must be attended by a first-aid trained person.

The criterion of 150 workers has been used solely in order to serve as a technical module for the number of items to be included in such a first-aid box; and the Minister is empowered[265] to issue instructions as to the proportion of items that had to be kept by undertakings with fewer employees.

Section 148(a) stipulates that an undertaking which employs more than 50 employees must employ a first-aid trained person to be in charge of the first-aid box and the administration of its contents. Of the five sections[266] that use the employment criterion, this is the only one that could be considered as a small business definition, because it takes into account the enterprise's overall number of employees. Section 148(a) acknowledges that an increase in the number of employees changes the structure of the enterprise's workforce, in that it can no longer concern itself only with production, sales and administration, but has to look after the workers' welfare as well.

Whether this determinant of 50 workers is the real borderline between a small business and a medium or large one, involving a genuine difference in its labour structure, or whether the difference is induced

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263 Sec.147(a).

264 Sec.148(a).

265 Sec.147(a).

266 Secs.123, 125, 126, 147(a) and 148(a).

artificially by the imposition of additional duties by the legislation, is difficult to ascertain.

(b.1)d. The Civil Defence Regulations (Equipment of Industrial Undertakings and Institutions) (Training of Workers) 1973 (5733)[267]

The **Civil Defence Regulations (Equipment of Industrial Undertakings and Institutions) (Training of Workers) 1973 (5733)** define several types of "organised undertakings".[268] Three of these definitions rely on the employment criterion.

The first defines an undertaking where at least 10 workers were employed.[269]

The second defines an educational institution or a hospital with fewer than 10 employees,[270] and

The third defines an undertaking where fewer than 10 workers are employed, and which belongs to the type of undertaking which the Minister of Defence has declared to be "sensitive" on account of the materials or processes used there.[271]

Had the first definition been studied out of context, without considering its relationship with the other two, it could have been regarded as a straightforward definition of an "organised undertaking" - namely one that employed at least ten workers. But because of the manner in which the employment criterion was used by the other definitions, it is necessary to reconsider the first definition after examining the other two.

The second definition uses the employment criterion in a negative manner, that is, it does not state a positive numerical determinant, such

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267 QT 3056, Sept. 13, 1973 (5733), p.1937.

268 Sec.1.

269 Sec.1(1).

270 Sec.1(1).

271 Sec.1(2).

as 10 or 100 employees, but stated a negative determinant "fewer than 10 employees", which means any lower number of employees - even one, or no employees at all. If in the case of an educational institution or a hospital, the number of employees was immaterial to its status as an "organised undertaking", why was it at all necessary for the legislator to use the employment criterion in its definition? The same enquiry arises in connection with the third definition, which, like the second one, uses the employment criterion in a negative manner which means that the number of employees is immaterial to its definition of an "organised undertaking".

The reason for the irrelevance of the employment criterion for the second and third definitions is understood to stem from the fact that because the Regulations deal with the training of workers for the purpose of civil defence, they are concerned only with those undertakings or institutions where such a training is imperative for the safety of its workers and/or occupants. Educational institutions, hospitals and "sensitive" undertakings are in greater peril in times of war than normal small undertakings with fewer than 10 employees, and so require the training of all present, regardless of whether they are workers or not. Still, this does not explain why it was necessary to use the employment criterion if the number of employees was immaterial, unless the Regulations intended to use it for its qualitative and not for its quantitative aspects; in the sense that an "organised undertaking" was meant to be one where employment took place, in contrast to a social or recreational place of gathering. If that was the legislator's reasoning, then it is felt that a clearer way of expressing it could have been found.

The elimination of the second and third definitions as potential definers of small business leaves only the first definition as a contender. It is obvious that an undertaking with fewer than 10 employees cannot be anything but a small business, but it is also plain that the legislator did

not intend to define a small business, except in so far as this was relevant to the purpose of training workers for the event of war. Consequently, such a definition cannot be accepted as a small business definition.

Another aspect for which the regulations use the employment criterion is for determining the quantity of equipment needed by an "organised undertaking"[272] for maintaining an "evacuation post". For this purpose Section 3 divides the "organised undertakings" into those with more than, or fewer than, 250 employees.

The use of the determinant of 250 employees in the present regulation is similar to that of the 150 employees used by **The Safety at Work Ordinance,**[273] in the sense that the **Civil Defence Regulations (Equipment of Industrial Undertaking and Institution) (Training of Workers)** have also used the employment criterion as a technical module that has correlated the quantity of equipment to the number of employees, and not as a definition of an enterprise.

(b.1)e. Labour Inspection (Organisation) Law 1954 (5714)[274]

The **Labour Inspection (Organisation) Law 1954 (5714)** deals with the establishment of a Labour Inspection Service: its functions, jurisdiction, the powers of its functionaries, and the operational procedures of the Service.

The Second Part of the Law is concerned with "Delegates, Committees and Safety Officers"; in this, Section 10 deals with the establishment of Safety Committees:

10(a) "In an undertaking in which not less than 25 employees are employed, there shall be a safety committee consisting of repre-

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272 Ch.B.

273 1970 (5730) Secs.147, 148.

274 SH 164, Aug. 25, 1954 (5714), p.202.

sentatives of the employees and representatives of the employer in equal numbers; in an undertaking in which the number of employees is less than 25 the employees and the employer may establish a safety committee by agreement."

The figure of 25 employees serves as the upper threshold for the undertakings that established a safety committee by agreement, and as the lower threshold for those whose safety committee consists of equal numbers of employers' and employees' representatives. Although the 25 employee determinant could be a valid criterion for the definition of a small business, it is suggested that the legislator did not indend it to serve any purpose other than for the appointment of "committee members", because in a small business it might not be possible to attain the 50-50 ratio representation of employers and employees.

(b.1)f. The National Insurance Regulations (Industrial Injury Insurance) 1954 (5714)[275]

For the purpose of establishing the insurance rates to be paid by the employer, **The National Insurance Regulations (Industrial Injury Insurance) 1954 (5714)** have classified all undertakings, actions and services according to their economic sectors, groupage and risk levels. The definition of a "large undertaking"[276] has been formulated for the same reason, namely the calculation of insurance rates, in relation to the risk involved.

A "large undertaking" is defined as one that employed on average at least 100 workers over a year, or at least 50 workers over any one month. Although this definition refers specifically to a large, and not to a medium or to a small undertaking, it is indicative of the number of

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275 QT 440, 1954 (5714), p.650, (as amended); Amended version "DINIM", p.879.

276 Sec.6.

employees expected to be found in a smaller size enterprise; because if the determinant of 100 or 50 employees is the lower threshold of the "large undertaking", any undertaking with less employees would be regarded as a medium or a small enterprise. Had the accepted size differentiation between enterprises been only that of small and large, it would have been possible to use the lower threshold of the large enterprise as the upper threshold of the small one, and thus use the one definition as appropriate for both sizes; but because the accepted in-between size of a "medium undertaking" is missing, the definition of the "large enterprise" cannot serve as a definition for any other size except the one it was originally intended to define.

(b.1)g. Labour Inspection Regulations (Safety Officers) 1965 (5725)[277]

As indicated by their title, the **Labour Inspection Regulations (Safety Officers) 1965 (5725)** set out to establish the functions and duties of the safety officers, rather than the direct implementation of safety regulations.

The Second Supplement of the Regulations distinguishes between three types of undertakings that are obliged to appoint a safety officer; those that[278] employ at least 500 workers; those that[279] employ at least 150 workers and belong to one of 13 specified industries;[280] and those[281] believed by the District Superintendent to involve a risk justifying the

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277 QT 1748, 1965, p.2386; Amdt. QT 2985 (Mar. 26, 1973) p.996; QT 3048 (Aug. 19, 1973) p.1812.

278 Second Supplement, Sec.1.

279 Second Supplement, Sec.2..

280 (1) Mining and quarries, (2) wood or cork, (3) processing of wood and wood products, (4) paper or cardboard processing and/or products, (5) leather and/or leather goods, (6) natural and synthetic rubber products, (7) the chemical and pharmaceutical industry, (8) basic metal industry, (9) other metal products, (10) machine and machine-part manufacturing, (11) electrical instruments and equipment, (12) transportation equipment, (13) petrol and oil products.

281 Second Supplement, Sec.3.

appointment of a safety officer.

According to the **Labour Inspection Regulations (Safety Officers) 1965 (5725)**, the industrial spectrum consists of large undertakings with a minimum of 500 employees; medium undertakings with a minimum of 150 employees and a maximum of 500 employees; and small undertakings with fewer than 150 employees. Had the adjectives small, medium or large accompanied these numerical determinants, and had the lower threshold of 150 employees not been restricted to 13 specific industries, these definitions could have been accepted as definitions of small, medium and large enterprises. Furthermore the fact that the **Labour Inspection Regulations (Safety Officers) 1965 (5725)** used a number-of-employees determinant different from that used by the **Labour Inspection (Organisation) Law 1954(5714)**[282] indicates that the latter's determinant of 25 employees was not intended as a small business definition either.

(b.2) Workers' sanitation amenities at work

The provision of adequate sanitation amenities has featured widely in the Israeli legislation, not merely as a concern for workers, but also for other sectors of the population, particularly for children, the aged and the sick, and for enterprises frequented by the public, such as restaurants and swimming-pools. The satisfaction of the legal requirements regarding sanitation is usually a pre-requisite for the grant of a business licence. Common to all legislations concerned with hygiene is the relation between the actual number of the amenities to be provided, and the potential number of users they are to serve.[283] Consequently, their use of the employment criterion has to be viewed in this context and not in relation to small businesses.

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282 Labour Inspection (Organisation) Law 1954 (5714), Sec.10(a).

283 The UK Washing Facilities Regulations 1964; Sanitary Conveniences Regulations 1964.

(b.2)a. Business Licensing Regulations (Medical Laboratories) 1977 (5737)[284]

The **Business Licensing Regulations (Medical Laboratories) 1977 (5737)** use the employment criterion in the First Supplement, which specifies the sanitation requirements[285] for each specified number of employees from 1 up to 100.

The present regulations cannot be considered to define a small business, because they are concerned with the relation between the number of employees and the quantity of sanitary installations.

(b.3) Employers' social responsibility

Employers have a social responsibility in addition to their economic one, a fact which has been recognised by Israeli legislation in the **Disabled In War (Employment) Regulations 1951 (5711)**, which use the employment criterion for the definition of the size of an employer that had to share in the social responsibility.

Ideally, disabled persons ought to be accommodated in society in such a manner as to enable them to lead an independent and dignified existence, regardless of the causes of their disability, or the reasons, and regardless of the direct or indirect gains or losses which accrue to their host society as a result of their disability. Yet those disabled in war tend to receive preference over other disabled in respect of rehabilitation, employment and accommodation. The subject of the "disabled in war" is an emotive one in every society that has experienced war, because it is felt that their disability has been incurred for the sake of the perpetuation of the society whence they had come, and for whom they fought.

The Israeli legislator has not left the issue of "social responsibility" to the discretion of the individual citizen, but has turned it into a

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284 QT 3753, Aug. 25, 1977, p.2460; Amdts: QT 3782, Nov. 13, 1977, p.4284.

285 The specifications consist of the exact numbers of toilets and washbasins for each group of employees.

statutory duty. The **Disabled in War (Employment) Regulations 1951 (5711)** are an example of legislation that has resolved the moral issue of "social responsibility" by imposing it as an indisputable statutory duty.

(b.3)a. The Disabled in War (Employment) Regulations 1951 (5711)[286]

The **Disabled in War (Employment) Regulations 1951 (5711)** establishes the social responsibility of an employer to employ a war disabled person, in two ways:

1. by reserving specific employments for war-disabled persons only;[287] and
2. by stipulating that a certain percentage of all employees in all employments should be war-disabled persons.[288]

Section 4 of the Regulations imposes on every employer of more than 10 employees the duty to employ war-disabled persons. The employers of 10 to 20 employees must employ one war-disabled person,[289] and those who employ more than 20 workers[290] must employ one war-disabled person for each 20 workers.[291]

It might appear that the Regulations define a small business according to the exclusive method of definition by exclusion, because

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286 QT 177, 1951, p.1090; Amdts.: QT 307, 1953 (5713), p.132; QT 437, 1954 (5714), p.594; QT 499, 1955 (5715), p.579; QT 555, 1956 (5716), p.52; QT 841, 1959 (5719), p.250; QT 1142, 1961 (5721), p.1702; QT 1206, 1962 (5722), p.76; QT 1614, 1964 (5724), p.1706.

287 Sec.2.

288 Sec.4.

289 Sec.4(a).

290 Sec.4(b).

291 The employer is not absolved from his statutory obligation to employ a war disabled person merely by proving that he has fulfilled his quota, as he is obliged to employ only those war disabled persons who were referred to him by the authorities that determine their priorities and type of occupation.

they exclude the employer of ten employees from their jurisdiction. This can be dismissed on two grounds:

(a) The regulations apply to all employers, whether in the private or the public sectors, and disregard the type of employment, whether commercial, educational or social.

(b) The reasons for the exemption of small employers are based not only on the interests of the employers but also on those of the disabled persons themselves, who might find themselves unwelcomed by a small, close group of 10 workers; in a larger unit their chances of social absorption would be better.

(b.4) Industrial relations

By industrial relations legislations are meant those legislative acts that establish the roles, rights and inter-relationships of the workers' and employers' representative organisations, between each other and between them and their members; but not the laws that deal with the rights or duties of the individual worker and/or employer, which fall into the category of labour law.

Industrial relations in Israel have been mainly dealt with by the **Collective Agreements Law 1957 (5717).**[292] A "collective agreement" is:

> "an agreement between an employer or an employer's organisation and an employees' organisation, made and submitted for registration under this Law, concerning all or any of the following matters: the engagement of employees and the termination of employment, terms of employment, labour relations and the rights and obligations of the organisations which are parties to the agreement".[293]

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292 SH 221, Feb. 28, 1957, p.63; Amdts.: SH 779, Aug. 8, 1975, p.223; SH 804, Apr. 8, 1976, p.138; SH 823, July 30, 1976, p.264.

293 Collective Agreements Law 1957 (5717), Sec.1.

There are two classes of collective agreements:

Sec.2(a) "Special collective agreements - in respect of a particular undertaking or employer - between an employer or an employers' organisation representing the employer and the representative organisation of the employees to whom the agreement is to apply".[294]

Sec.2(b) "General collective agreements, for the whole area of the State or a part thereof, in respect of particular branches of employment or all branches of employment, the agreement being between the representative employees' organisation, and an employers' organisation, of the branch of employment or area concerned, as the case may be".[295]

The collective agreements have wide jurisdictional powers, as they are imposed not only on their signatories, but also on non-unionised employers and employees. As a result, a collective agreement is in effect a legal act.

Section 33(f) of the Law authorises the Minister of Labour to issue the necessary supplementary regulations. Accordingly, he has issued the **Collective Agreements Regulations (Professional Handling Fees to an Employers' Association) 1977 (5737)**, Section 11 of which uses the employment criterion for the size definition of a business.

(b.4)a. The Collective Agreements Regulations (Professional Handling Fees to an Employers' Association) 1977 (5737)[296]

These Regulations impose an unusual duty on employers: the payment of a fee to an employers' association of which they are not

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294 Ibid., Sec.2(a).

295 Ibid., Sec.2(b).

296 QT 3729, June 26, 1977, p.2025; Amdt.: QT 3973, Apr. 26, 1979, p.1020.

members.[297] Indirectly this means that membership of an employers' association is not voluntary but obligatory, because the clearest sign of membership is the payment of membership fees, which establishes the contractual relationship between the member and his association.

Although these Regulations do not impose on the employer the permanent obligation of paying regular membership fees to a specific employers' association - but only an occasional duty of paying handling fees, if and when his undertaking has been included in a collective agreement, to which that employers' association was a party - these payments are not voluntary, since they are not consequential to a contractual relationship, but are the result of a statutory obligation.

Despite the dissimilarity between membership fees and these occasional handling fees, the mere fact that they have to be paid by an unwilling employer turns the employers' association from the voluntary association that it is supposed to be into a statutory one, and therefore any claim that it represents free enterprise ought to be ignored. By forcing employers to contribute to the financial viability of employers' associations, the authorities ensure that their perpetuation depends on Government-channelled finances. This dependency on non-voluntary financial contributions terminates their independency and turns them unofficially into Government organs.

That such an institutionalisation of employers' associations might contribute to improved industrial relationships might be a valid claim; yet

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297 Secs.1(a), 1(b).

yet it does not alter the fact that it undermines the foundation of free enterprise. Prima facie the **Collective Agreements Regulations (Professional Handling Fees to an Employers' Association) 1977 (5737)** seem to strengthen the employers' associations, but in effect they weaken them by taking away their independence, and so neutralising them. This assertion has been reinforced by studying those undertakings that are exempted from the Regulations.[298]

Common to all the exempted undertakings is their "non-capitalist" ownership, such as: statutory corporations;[299] local councils;[300] kibbutzim or co-operative settlements;[301] a kibbutz movement;[302] a co-operative movement;[303] a workers' settlement,[304] or any of its members;[305] the General Workers Union - or its corporations;[306] a charitable organisation;[307] the Jewish Agency; [308] Keren Hayesod;[309] the United

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298 Sec.3

299 Secs.3(1), 3(2).

300 Sec.3(3).

301 Sec.3(4).

302 Sec.3(5).

303 Sec.3(6).

304 Ibid.

305 Ibid.

306 Sec.3(7). The General Workers' Union, through its various corporations, is the owner of a high percentage of the industry in Israel.

307 Sec.3(8).

308 Sec.3(9). A quasi-Government organ which provides liaison between the State and Jews living outside Israel.

309 Sec.3(9). A quasi-government organ which originated before the declaration of the State of Israel and was active in the purchase and development of land in Israel. Presently it is quasi-defunct, but still owns land.

Jewish Appeal;[310] or an undertaking of which any one of the mentioned owners or the State are the controlling employers.[311] All the enumerated employers belong to the "public" sector - or rather the "non-private" sector, because "public ownership" infers ownership by all the people, and among the mentioned exempted are also undertakings owned by part of the people, such as kibbutzim, co-operatives and workers' unions.

As regards the private sector, it is divided into:

large employers whose turnover exceeded IL5m or who employed more than 20 employees;[312] and

small employers whose turnover did not exceed IL5m or who employed fewer than 20 employees.[313]

The large employers are exempted from contributing to an employers' association specialising in the small business sector; and the small employers are exempted from contributing to an employers' association that did not specialisein the small business sector.

In the context of the present regulations, a small business is therefore onenthat employs fewer than 20 workers, or has a turnover of less than IL5m. The two alternative criteria - employment and turnover - enable one criterion to compensate for the other in those industries that are either more capital- or more labour-intensive, and where a single criterion definition might misrepresent the economic facts. The fact that the numerical determinants of the definition have been correlated by the legislator with the membership of a small employers' business association

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310 Sec.3(9). A quasi-Government organ with the aim of raising contributions from Jews living outside Israel.

311 Sec.3(10).

312 Sec.3(11)(a).

313 Sec.3(11)(b).

indicates that the definition has not been originated merely for the present regulations, but represents an accepted definition of small businesses in Israel.

(c) The Employment Criterion in Israel's Economic Law

Countries that have recently acquired new identities, like Israel and China, tend to be more concerned with the ideology and planning of their economies than the longer-established countries such as the UK and the USA. This is due to the fact that their new identity is usually a result of an ideological economic philosophy different from that practised before; although, as is known, the establishment of new and/or different economic philosophies was not the prime raison d'être of the State of Israel. For the founders of the State, who originated from eastern Europe and were influenced by socialist doctrines, the practice of a new economic philosophy had a deeper meaning than mere socialism. It was a symbolic break with the stigma attached to the economic past of the Jewish people.

New identities do not necessarily have to be correlated with socialism or any of its related economic branches, as is demonstrated by the current Islamic fundamentalism of Iran. When the new regime takes over it is occupied with establishing an economic philosophy that reflects its overall concept of government. Those "new identity" countries that practice orclaim to practice democracy, and use the organs of the law for the implementation of their new economic philosophies, use the law for dirigism of the economy more often than the more established countries. This phenomenon accounts for the relative existence of more economic laws in the new countries than in the established ones.

(c.1) The Tenants' Protection Regulations (Business Rents - Maximum Rates and Reductions) (Amendment No.2) 1979 (5739)[314]

The **Tenants' Protection Regulations (Business Rents - Maximum Rates and Reductions) (Amendment No.2)** were promulgated in 1979 by the first non-labour government of Israel. Being a new regime, it postulated a different economic philosophy from the one practised by its predecessors. The change of Government is relevant to the present Regulations, for since the promulgation of the **Tenants Protection Law (Consolidated) 1972 (5732)**, these are the first regulations that have differentiated small businesses from the other forms of business, and have mitigated their rent increases.

The Regulations divide all rent-controlled business premises into three categories, A, B and C,[315] and fix their rent increases accordingly. Group A is accorded the lowest rent increases and Group C the highest.

Category A included small family-owned grocery shops,[316] and other businesses[317] with a maximum yearly turnover of I.L.40,000, which are exempted from VAT.[318] Small family-owned grocery shops are considered to be those that are manned by their owner and/or his/her spouse, or child, with or without the assistance of one non-related workers.[319]

Category B includes small businesses that are not grocery shops,

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314 QT 3965, Apr. 1, 1979 (5739), p.942.

315 Sec.1.

316 Sec.1(a).

317 Sec.1(b).

318 Value Added Tax Law 1975 (5736), Sec.31(3).

319 Sec.1.(1).

and whose owners are registered as "small traders",[320] according to the **Value Added Tax Law 1975 (5736).**[321]

In category C are included all the rent-controlled business premises that did not belong to categories A and B.

Category A is divided into two distinct groups, grocery shops and other businesses. Belonging to the grocery shops[322] group entails compliance with the employment criterion only; and belonging to the other group relies only on the turnover criterion. Satisfaction of the employment criterion necesitates compliance with its qualitative as well as its quantitative characteristic, since it is not only the numerical determinant of one employee that determines inclusion in this group, but also the qualitative relationship of the other employees, that is, the owner, spouse or child. The working owner is judged by his relationship to the ownership, and the spouse or child by their family relationship to the owner, since not any family member can qualify, but only the very close ones.

Although the Regulations were enacted by a non-labour government that has pledged to support and uphold private enterprise, of which the owners of controlled business premises form a part, they distinguish between small and the large entrepreneurs, and fix their rent increases accordingly.

Because the Regulations were motivated by a mixture of economic dirigism and social considerations, their definition of what constituted a small business can be accepted only as a specific definition

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320 Sec.1.

321 A "small trader" was defined by the 1979 amendment to the VAT Law 1975 (5736) as having a turnover of IL1,000,000.

322 In 1979 grocery shops, especially those conducted from rent controlled premises, were mostly owned by elderly couples who could not compete with the sophisticated supermarket operations, which in Israel, as in other countries, have taken over and overtaken the business which was previously the grocery shop's domain. Thus it was mostly elderly couples, who could not adapt themselves to new and more profitable occupations, that continued to operate the small grocery shops with their dwindling financial returns. For them a rent increase could be ruinous.

and not as a general definition of a small business.

(c.2) Export Order (Exporters' Guarantees) 1959 (5719)[323]

The **Export Order (Exporters' Guarantees) 1959 (5719)** is a further example of how the employment criterion was used by legislation belonging to the branch of economic law.

In the Israeli Government's efforts to increase the country's exports, it has given exporters many concessions. These take the form of deferred duties on imported materials, Government loans at low interest rates and favourable rates of exchange for foreign monies. These benefits are accorded only to those exporters that are recognised as "authorised exporters". Invariably, also, non-deserving exporters have tried to benefit from the offered incentives; and in order to prevent fraudulent claims for such benefits, the present Order empowers the appropriate authorities to ask for a general or a specific guarantee[324] from the exporter, undertaking to refund any given concession in the event of non-exportation of the relevant products.

The Regulations define several types of authorised exporters,[325] but the employment criterion has been used only for the definition of an "authorised diamond exporter".[326] This title is conferred on the exporter specialising in the export of diamonds, upon the fulfilment of one of the following two conditions:

(1) the regular employment of at least 50 workers and the exportation of diamonds with a minimum value of $100,000 calculated at FOB prices;[327] and

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323 QT 876, 1959 (5719), p.885; Amdt.: QT 1738, 1965 (5725), p.2244.

324 Sec.2(b).

325 Sec.1.

326 Secs.1(1) 1(2).

327 Sec.1.(1).

(2) the exportation of diamonds with a minimum value of $500,000 calculated at FOB prices.[328]

By using the employment determinant of 50 workers as the lower threshold of the definition of an "authorised diamond exporter", the **Export Order (Exporters' Guarantee) 1959 (5719)** defines simultaneously two kinds of diamond exporters, the small ones that employ less than 50 workers, and the larger ones that employ more than 50 workers, since the lower threshold of one group is the upper threshold of another.

It seems that the legislator has used two different yardsticks for deciding the number of workers that constituted a small business. When the issue is exclusion from benefits, a small business is deemed to employ a reasonable number of workers, approximately 50. But when the legislation deals with exemption from duties, a small business is considered to be unusually small, and is believed to employ as few as one worker.

(d) Summation

Israeli legislation applies the employment criterion in 14 legislative acts, of which two belong to the law of taxation, 10 to labour law, and two to economic law. Out of these, only two legislations correlate the number of employees with the adjective "small". One uses it for the actual definition of a "small business",[329] while the other defines a "small trader",[330] more in the sense of a self-employed person than as a business.

When the law defines a phenomenon according to the positive method of definition by stating that a specific phenomenon is being

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328 Sec.1(2).

329 Fire-Fighting Services Regulations (Fire-Extinguishing Equipment in Industrial Undertakings or Workshops) 1972 (5732).

330 The Value Added Tax Law 1975 (5736).

defined according to certain criteria and particular determinants, that definition ought to be accepted as the correct definition of that defined, within the context of that individual law. With the exception of a legislation that is subordinated to a constitution, in countries whose legislation is based on one, it is within the authority of every legislative act to define the subject it elects to define, according to its own choice of criteria and numerical determinants. It might be possible that, outside the scope of that legislation, such a definition might not reflect a realistic image of the defined. Still, this does not invalidate the definition of that particular defined within the context of that particular legislation.

Apart from legislation that uses criteria in conjunction with the positive method of definition, where the relationship between the criteria and the defined is clear, all other instances where various criteria have been used by the other methods of definition, such as the exclusive or negative ones to define particular phenomena, need to be investigated in detail in order to establish the exact identity or function of the defined which the criteria are intended to define. If a clear link is lacking between the criteria and the defined, the intention of the legislation is not self-evident and, except for the two mentioned legislative acts that have clarified their reasons for using the employment criterion - in order to define a small business or trader - the motive of the other twelve measures is still to be established.

It is suggested that in all the twelve legislative acts in which no clear reason is given for their having employed the employment criterion, this has been introduced in order to describe the capacity and/or the ability of the defined, with a particular number of employees, to perform or undertake specific tasks - in each case an attainment which depended on the actual number of employees rather than other factors. For example, in the **Income Tax Instructions (Book-keeping) (No.2)**

1973 (5733) (as amended), the number of employees indicates the ability and capacity of the enterprise to cope with intricate bookkeeping procedures. In the safety-related measures such as the **Fire Fighting Services Regulations (Fire Extinguishing Equipment in Hospitals) 1972 (5732)**, the **Safety at Work Ordinance (New Version) 1970 (5730)** and the **Civil Defence Regulations (Equipment of Industrial Undertakings and Institutions) (Training of Workers) 1973 (5733)**, the number of employees is related to their ability to cope with emergencies, such as fire and war hazards. The smaller the number of employees, the less stringent are the law's safety procedure requirements. The assumption is that within a small group, the individual is more capable of looking after his own and others' safety than when he is a member of a large group, when he needs the protection of the law.

As to the **Labour Inspection (Organisation) Law 1954 (5714)**, here the specified number of employees indicates the threshold below which the enterprise is able to reach agreements between employers and employees, without the intervention of the law; and in the **Labour Inspection Regulations (Safety Officers) 1965 (5725)**, the number of employees is correlated with the number of inspectors, that is to say, to the inspector's abilities to cope with a given number of employees; while the **Licensing Business Regulations (Medical Laboratories) 1977 (5737)** relates to the capacity of the sanitary installations to serve a particular number of employees; and the ability to absorb additional employees is the factor in the **Disabled in War (Employment) Regulations 1951 (5711).**

The Collective Agreements Regulations (Professional Handling Fees to an Employers' Association) 1977 (5737) assumes that below a certain number of employees an enterprise does not

benefit from the services of an employers' association of which it is not a member, and is capable of coping with its industrial relations problems on its own. In **The Tenants Protection Regulations (Business Rents – Maximum Rates and Reductions) (Amendment No.2) 1979 (5739)**, the number of employees indicates the owner's inability to pay higher rents; while in the **Export Order (Exporters' Guarantees) 1959 (5719)**, the number of employees supplies the opposite proof: the employer's ability to export goods. The odd man out is the **National Insurance Regulations (Industrial Injury Insurance) 1954 (5714)**, which defines a "large undertaking" according to the positive method of definition.

Understanding the function of the employment criterion in the abovementioned legislation does not in itself explain the legislators' choice of the various determinants of numbers of employees. Although it must be accepted that every individual legislator must have had his own good reasons for doing so, yet on some occasions those must have been of such a very parochial or personal nature as to obliterate their common rationale, which would have otherwise shown up under examination.

Legislation that cannot demonstrate a consistent logical pattern, or underlying social or economic considerations, loses much of its effectiveness, because then each regulation becomes a separate entity out of harmony with the rest of the legal system, giving rise to justified accusations of arbitrariness. An extreme example of such arbitrariness can be found in the Israeli **Income Tax Instructions (Bookkeeping) No.2 1973 (5733)**, which are arbitrary because no rationale or consistency emerges from the numerical determinants of the employment and other criteria that they used. When employment determinants are used on some 17 occasions, in 15 different permutations, within one legislative act, it is impossible even to speculate about the reasons for

this, because no common denominator between the definitions, the defineds, and the motivations for their definitions, can be found. Whatever were the legislator's justifications for producing such complicated legislation, it is nonetheless bad legislation, because it does not result in a clear definition of any one defined.

Conclusion

The employment criterion has been used in the legislation of the USA, the People's Republic of China, the UK, and Israel. In the USA, it was used according to the positive method of definition, in order to define a small business, only in those legislative acts which were promulgated exclusively for the purpose of promoting and assisting small businesses, all of which originated from the **Small Business Act 1953.**[330] Yet despite their common interest of assistance to the small business sector, the actual numerical thresholds of numbers of employees that constituted a small business varied from one law to another, and within laws as well.

The other legislative acts that used the employment criterion for the sake of differentiating between enterprises with different numbers of employees did not define small businesses per se, but inferred that they were small by their exclusion or exemption from the legislation's jurisdiction. The question of whether the exemption or exclusion of small employers from certain duties constituted a definition of a small business, had to be examined individually in each piece of legislation, and had to be determined on the particular merits of that legislative act.

In the legislation of the People's Republic of China, no positive definition of small businesses exists. Consequently all those legislative

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330 Prior to the Small Business Act 1953, the only Act that defined small businesses in a positive manner was The Selective Service Act 1948.

acts which used an employment criterion, had to be scrutinised as to their hidden motivation and rationale. The scarcity of legislative resources in the People's Republic of China must be understood within the overall structure, history and philosophy of that country, where the "rule of law" as understood by western concepts had not prevailed; and even before the Communist takeover, Confucian philosophy had advocated mediation in preference to legal proceedings. As to small businesses there, it can be said that they have received a de facto recognition but not as yet a de jure one. Consequently the sparse legislation that exists in the People's Republic of China has not dealt with small businesses as such, and the law's recognition of their existence had to be deduced from the indirect inferences of their small number of employees.

UK legislation, like that of the USA, has used the employment criterion for the positive definition of small businesses, whenever the legislative acts set out to promote and assist small business, as in the **Inner Urban Areas Act 1978**, and the assistance schemes which were authorised by **The Employment Subsidies Act 1978.** Other legislative acts that used the employment criterion employed it according to the exclusive method of definition, which excluded or exempted enterprises with a small number of employees from certain duties imposed on the larger employers. A similar use of methods of definition has been noticed in the legislation of the USA.

Relative to its size, population, years of existence and economic strength, the Israeli legislation has used the employment criterion on more occasions than any of the other three researched countries. The quantity of legislation does not increase or diminish in a direct proportion to the size of the area it covers or the number of persons it controls, but neither does it multiply or decrease in an inverse proportion to these factors. All that can be said is that large countries tend to benefit from

economies of scale, not only in the field of economics but also in that of legislation.

More specific explanations for the abundance of Israeli legislation that used the employment criterion could be: either that the differentiation between enterprises according to the number of their employees indicated the legislator's positive or negative concern with some of these differentiated groups; or simply that the legislator did not concern himself with the totality of the legislation, and the adverse effects that such numerous different determinants of the employment criterion could have on the overall confidence of the business community under his jurisdiction.

The conclusions from comparing the manner in which the employment criterion has been used in the four researched countries are straightforward, and are as follows:

1. When the positive method of definition is employed by a piece of legislation, its use of the employment criterion defines the phenomenon it claimed to define, whether it is a business or a non-business, a small enterprise or a large one.
2. When the exclusive method of definition is employed by a piece of legislation, it is difficult to ascertain what phenomenon is being defined, and the full background of the legislation has to be considered before any valid conclusions can be reached.
3. No legislation that used the employment criterion has created a legal definition of a small business, merely a juristic one.
4. The legislation of the USA, the UK, and Israel has had positive juristic definitions of the small business, while the People's Republic of China has used only the exclusive method of definition in its juristic definitions.

5. The numerical determinants of the employment criterion have varied from one country to another, within the country, and within the individual legislative acts as well.

6. The employment criterion has sometimes been used as an exclusive criterion and sometimes in conjunction with other criteria.

7. The multitude of different employment determinants have fogged the meaning of a small business, and consequently its definition. Thus they have hampered the recognition and promotion of this independent concept.

CHAPTER THIRTEEN

THE TURNOVER CRITERION IN THE LEGISLATION OF THE USA, THE PEOPLE'S REPUBLIC OF CHINA, THE UK AND ISRAEL

Introduction – "certain" and "uncertain" criteria

The turnover criterion is the second most popular criterion after employment as a definer of the small business phenomenon. Different terms for the same criterion are sales volume, which is used by US legislation; business turnover, which is used by Israeli legislation; and sales turnover. Usually the turnover criterion acts as a quantitative determinant as a result of the numerical specifications which are attached to it, but the legislation of the People's Republic of China uses it only as a qualitative criterion without numbers to quantify it. The reasons for such general legislation stem from the philosophical and historical attitudes of the Chinese to the role of law in society, which they see as a guide-line to behaviour rather than a strict code.

By its nature, the turnover criterion is linked to monetary values, which are unstable these days on account of the international malaise of inflation. This inbuilt variance outdates legislation that relies on the turnover criterion, unless periodic amendments of its monetary determinants are made. The vulnerability of monetary criteria might be an additional explanation as to why the legislators of the People's Republic of China, besides their ideological considerations, did not use it as a quantitative criterion, particularly as China has experienced the ravages of inflation to a greater extent than any of the other three researched countries.[1]

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1 Chou En-lai, A Great Decade, Foreign Language Press, Beijing, 1959, p.2.

Similarly, the explanation of why out of the four researched countries only the Israeli legislation has introduced an automatic inflation adjustment clause into legislations from which inflation might affect its revenue is that at present Israel suffers from uncontrollable, spiralling inflation. The argument against the use of monetary criteria is that even if the legislators attempt to update the numerical determinants and bring them into line with prevailing monetary values, the legislative process is too slow to keep up with the changes in the economic situation.[2]

Monetary criteria are of two types, "certain" and "uncertain". Turnover is a "certain" criterion; whereas profits, assets, capital assets, net worth, stock value and capital equity are "uncertain" criteria. The "certainty" of turnover lies in its substantiable nature, because the occurrence and the value of a sale transaction is a verifiable fact[3] requiring neither accounting nor economic interpretations; but the ascertainment of an accrued "business profit" depends on arbitrary monetary assessments of such factors as trading stocks, capital assets, depreciation, debtors and inflation, at a specific point in time.

(i) The Turnover Criterion in the Legislation of the USA

US legislation uses the terms sales volume, sales turnover or annual receipts, but not the single term turnover, for the description of the income accrued to a business from its sales. The sales volume criterion is used in conjunction with low numerical determinants, in three situations - when the legislator has intended:

1. To promote and assist small businesses.
2. To exempt small businesses from certain paperwork requirements.
3. To exempt small businesses from specific legal duties.

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2 Except when the inflation factor is built into the legislation as it is in some Israeli legislation. See p.282.

3 A "sale" can be nullified by a "return", or its monetary value altered by the issuance of credit or debit notes.

(a) Turnover Determinants for Government Assistance Programmes

This category consists of regulations that were authorised by prime legislations such as the **Small Business Act 1953**[4] which recommended the use of "dollar volume of business"[5] for the definition of small businesses, and the **Small Business Investment Act 1958**,[6] which adopted the **Small Business Act**'s definition.

The meaning and method of calculating "dollar volume of sales" or "annual receipts" has been explained as the gross sales income (less returns and allowances for sales of fixed assets, and inter-affiliate transactions) of a concern, inclusive of home and export sales, its local and foreign branches.[7] "Sales" means the sales of products, services, interests, rents, fees, commissions or other sources as accounted in the accounting books of the preceding year.[8] All "sales volume" calculations for the sake of defining a small business for Government assistance programmes are to be done on the basis of the average annual receipts of a concern for the preceding three fiscal years.[9] The actual meaning of "sales" and the method of calculating them are the same for all Government assistance programmes, but their numerical determinants vary from one assistance programme to another.

Whenever the legislation uses the sales volume criterion in order to define a small business for the purpose of establishing its eligibility for Government assistance, it uses the positive method of definition, which

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4 PL 85-536, Sec.5(b)6 73, Stat.385.

5 Small Business Act 1953 (as amended), Sec.3.

6 Sec.103(5) of the Small Business Investment Act of 1958 (as amended) reads: "The term 'Small Business concern' shall have the same meaning as in the Small Business Act."

7 13 CFR part 121, Sec.121 3-2(b), p.242.

8 Ibid.

9 13 CFR part 121, Sec.121 3-8, p.250.

minimises the doubts as to the legislator's wishes or intentions.

(a.1) The Government procurement program

For a small business to benefit from special privileges in bidding for Government contracts, its sales volume must not exceed a pre-determined threshold, which varies from one sub-industrial sector to another. The lowest of these determinants was a sales volume of $1.5 million and the highest $12 million. These thresholds are fixed by the Small Business Administration and the representatives of the relevant industrial sectors and their fulfilment qualifies for the Government procurement programme.

For the purpose of bidding for Government contracts, the following determinants of annual sales were the small business definition of different industries:

Sales volume	Industry
$1.5 million	cleaning and dyeing[10]
$2 million	services[11]
$3.5 million	(a) services that require the use of one or more helicopters or fixed-wing aircraft[12] (b) refuse collection[13]
$4 million	(a) laundry services[14] (b) computer programming[15] (c) tyre recapping[16] (d) data processing[17]

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10 13 CFR Sec.121 3-8(e)(8)(ii).

11 Ibid., Sec.121 3-8(e).

12 Ibid., Sec.121 3-8(e) 15.

13 Ibid., Sec.121 3-8(e)(16).

14 Ibid., Sec.121 3-8(e)(8)(i).

15 Ibid., Sec.121 3-8(e)(9).

16 Ibid., Sec.121 3-8(e)(12).

17 Ibid., Sec.121 3-8(e)(13).

$4.5 million	janitorial and custodial services[18]
$5 million	sub-divisions of construction industry[19]
$5.5 million	food services[20]
$7 million	(a) flight training services[21] (b) computer maintenance[22] (c) motor car rental[23] (d) trucking and warehousing of refuse collection[24] (e) general packing and crating[25]
$7.5 million	(a) engineering services[26] (b) base maintenance[27] (c) marine cargo handling[28]
$8 million	motion picture services[29]
$9 million	naval architecture and marine engineering[30]
$9.5 million	dredging[31]
$12 million	construction[32]

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18 Ibid., Sec.121 3-8(e)(3).

19 Rev.13 Amdt.7, 40 FR 51033, Nov. 3, 1975.

20 13 CFR Sec.121 3-8(e)(7).

21 Ibid., Sec.121 3-8(e)(10).

22 Ibid., Sec.121 3-8(e)(14).

23 Ibid., Sec.121 3-8(e)(11).

24 Ibid., Sec.121 3-8(e)(16).

25 Ibid., Sec.121 3-8(f)(3).

26 Ibid., Sec.121 3-8(e)(1).

27 Ibid., Sec.121 3-8(e)(4).

28 Ibid., Sec.121 3-8(e)(5).

29 Ibid., Sec.121 3-8(e)(2).

30 Ibid., Sec.121 3-8(e)(6).

31 Ibid., Sec.121 3-8(a)(2).

32 Ibid., Sec.121 3-8(a)(1).

The threshold determinants of the sales volume criterion are not static and are amendable, but the time lapse between each such amendment is not fixed or regular.[33]

(a.2) Small Business Administration loans

Eligibility for a business loan at favourable interest rates from the Small Business Administration depends on different sales volume determinants from those that qualify for the Government Procurement Program. For the purpose of loans, the span of the different sales volume determinants range from $17.5 million at the highest, to $275,000 at the lowest. For the purpose of qualifying for Small Business Administration loans the following determinants of annual sales serve as the small business definition of the various industries:

Sales volume	Industry
$10 million	custom livestock feeding[34]
$9.5 million	(a) wholesale business[35] that was not mentioned in Schedule C[36] (b) construction[37]
$8 million	(a) motion picture production[38] (b) service of motion picture production[39]
$6.5 million	qualified trucking and crating[40]
$3.5 million	engineering services[41]

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33 Rev.13 39 FR 44424 Dec. 24, 1974, as amended by Amdt.5, 40 FR 32824 Aug. 5, 1975; 40 FR 36310 Aug. 20, 1975; Amdt.6, 40 FR 50519 Oct. 30, 1975; Amdt.8, 41 FR 4013 Jan. 28, 1976; Amdt.17, 42 FR 36449 July 15, 1977.

34 13 CFR Sec.121 3-10(b)(i).

35 Ibid., Sec.121 3-10(g)(1)(ii).

36 Schedule C enumerates the turnover or employment determinant, among others, also of the wholesale trader.

37 13 CFR Sec.121 3-10(9).

38 Ibid., Sec.121 3-10(d)(8).

39 Ibid., Sec.121 3-10(d)(9).

40 Ibid., Sec.121 3-10(f)(4).

41 Ibid., Sec.121 3-10(d)(10).

$3 million	(a) hotel/motel[42] (b) power laundry[43] (c) service and rental of cable television[44]
$2 million	(a) industries[45] not mentioned in Schedule D[46] (b) services[47]
$1.5 million	(a) car and parking lots[48] (b) convalescent/nursing homes[49] (c) medical laboratory[50] (d) grain storage depot[51] (e) passenger and freight transportation[52]
$1 million	raising of livestock[53]

In order to be eligible for a disaster loan under Section 7(b)(4) of the **Small Business Act 1953**, a business is considered small if its annual turnover does not exceed $275,000.[54]

Schedule D[55] of the **Small Business Act Size Standards**

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42 Ibid., Sec.121 3-10(d)(2).

43 Ibid., Sec.121 3-10(d)(3).

44 Ibid., Sec.121 3-10(d)(12). (Deleted Rev.13 Amdt 20, 43 FR 19352 May 5, 1978).

45 Ibid., Sec.121 3-10(c)(2).

46 Schedule D enumerated 15 types of retail outlets; see note 55 p.345.

47 13 CFR Sec.121 3-10(d)(1).

48 13 CFR Sec.121 3-10(d)(4).

49 13 CFR Sec.121 3-10(d)(6).

50 13 CFR Sec.121 3-10(d)(7).

51 13 CFR Sec.121 3-10(f)(3).

52 13 CFR Sec.121 3-10(f)(1).

53 13 CFR Sec.121 3-10(j).

54 13 CFR Sec.121 3-10(k).

55 Rev.13 Amdt.5, 40 FR 32826 Aug. 5, 1975.

Regulations enumerates the sales volume determinants of concerns that were primarily engaged in retailing. The schedule deals with 15 types of retail outlets, such as food stores, car dealers, furniture and fashion stores; and affixes to them turnover determinants starting at $2.5 million and rising to $17.5 million.

Schedule G[56] deals with the industries relating to Petroleum Administration for Defence, and defines their small business status according to a turnover criterion that varies from $1 million - $2 million.

In total there are some 27 different upper threshold determinants of the turnover criterion, which define the small business status of 70 different industries for the purpose of qualifying for Government assistance. This means that, on average, every 3.5 industries have a different turnover determinant.

Despite the legislator's belief that a method of allotting each industry its individual threshold determinant will reflect a more correct reality of what constitutes a small business than a sweeping determinant, it has achieved opposite results; as such a state of affairs, whereby every few industries have their own tailor-made "legislation", does not promote understanding of the law and cognisance of one's rights and/or obligations.

(b) Turnover Determinants for Paperwork Exemptions

Legislation using the turnover criterion for the purpose of exempting certain sizes of enterprises from some paperwork requirements deals with accounting exemptions in the telecommunications sector of the economy. These exemptions have been granted in accordance with the exclusive method of definition, whereby a defined is defined indirectly as a result of its exemption. Consequently, if any of the threshold determinants does in effect define a small business, this would not be apparent from the actual wording of the legislation, but would have to be verified, since as the

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56 Rev.13 Amdt.7, 40 FR 51033 Nov. 3, 1975.

defineds are never referred to as a small or a large business, but as classes A, B, C and D, each of which is differentiated by its upper threshold of "annual operating revenues".

(b.1) The Uniform System of Accounts for Telephone Companies – Class A, B, C and D (Regulations)[57]

The regulations of the Uniform System of Accounts for Telephone Companies are applicable only to companies. The interpretation of "company" is "the accounting company", meaning the head office of the holding company that is responsible for the accounts and not just a subsidiary that deals with the technical aspects of telephones. The Regulations allocate the following turnover thresholds to Classes A, B, C and D companies. Class A consists of companies with an annual operating revenue that exceeds $250,000; Class B, companies whose annual turnover is between $100,000 and $250,000; Class C, companies with a $50,000 to $100,000 turnover; and Class D, companies whose revenue does not exceed $50,000.

The accounting demands are related to the company's turnover: the higher this is, the more stringent the accounting demands; and the lower, the more lenient. Class D, with the lowest turnover and therefore the easiest accounting requirements,[58] is subject to a voluntary system of accounting: "It is recommended but not required that Class D companies keep the accounts prescribed in Part 33 of this Chapter." Class C[59] is compulsorily required to keep accounts in accordance with Part 33. Class B[60] must adopt a more detailed accounting system than Class C; but in

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57 47 CFR part 31, p.178 as authorised by Sec.4, 48 Stat. 1066, as amended, 47 USC 15; interpreting or applying Secs.219, 220, 448, Stat. 1077, as amended, 1078; 47 USC 219,220.

58 47 CFR Sec.31.01-1(e), p.182.

59 Ibid., Sec.31.01-1(d).

60 Ibid., Sec.31.01-1(c).

contrast to Class A it can keep its accounts under a condensed classification, while Class A[61] has to adhere to all the detailed requirements without any short cuts.

In this classification of companies into four classes, there is no reference to small businesses as such; but the fact that from the company with the smallest turnover the simplest accounting details are expected, shows a correlation between size and legal obligations.

Another classification of these companies, besides the four classes, is according to a $1m turnover determinant. Those that exceed this figure are subject to disclosure requirements regarding customers,[62] and are also required to obtain the Communications Commission's[63] approval for the purchase of telephone plant;[64] and if the cost of the proposed purchase exceeds $100,000, the company is expected to submit operating plans as well.[65]

(b.2) The Uniform System of Accounts for Radiotelegraph Carriers (Regulations)[66]

The Uniform System of Accounts for Radiotelegraph Carriers classifies these carriers into two classes:

Class A denotes carriers whose average annual operating revenue exceeds $100,000;[67] and

Class B denotes carriers whose average annual operating revenue is between

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61 Ibid., Sec.31.01-1(a).

62 Ibid., Sec.31.01-2 (Records).

63 The Federal Communications Commission is the body that regulates and supervises the activities of the telecommunications industry. Since it is empowered to grant licences, without which an operator cannot start or continue in business, it is a very powerful organisation.

64 Supra, note 62, Sec.31.01-2.

65 28 FR 13039 Dec. 5, 1963, as amended, 31 FR 6418 Apr. 28, 1966.

66 47 CFR part 34, p.327.

67 Ibid., Sec.34.01.2(a).

$50,000 and $100,000.[68]

The correlation between a low turnover and reduced legal obligations is expressed by the condensed accounting procedure which is allowed to Class B with the lower turnover.

In addition to Class A and B carriers, the regulations recognise the existence of a smaller carrier whose turnover is below $50,000, but they do not name it Class C. Carriers with such a low turnover are not expected to keep a uniform system of accounts, but were not prevented[69] from doing so if they wished.

(b.3) The Uniform System of Accounts for Wire-Telegraph and Ocean-Cable Carriers (Regulations)[70]

The Uniform System of Accounts for Wire-Telegraph and Ocean-Cable Carriers divides these carriers[71] in a manner similar to that in which the regulations of the Uniform System of Accounts for Radiotelegraph Carriers divide their carriers; that is, into two classes, A and B, with identical threshold determinants, $100,000 for Class A, and $50,000 to $100,000 for Class B. In addition they have also allowed for another group with a lower turnover than $50,000 per annum. The type of concessions which were granted to Class B and the classless group[72] with the under-$50,000 turnover are the same as those granted to the radiotelegraph carriers.

(b.4) The Uniform System of Accounts for Companies Supplying Natural Gas (Regulations)[73]

The Uniform System of Accounts is applied also to companies that

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68 Ibid.

69 Ibid., Sec.34.01-2(b).

70 47 CFR Part 35, p.423.

71 47 CFR Sec.35.01-2(a).

72 47 CFR Sec.35.01-2(b).

73 18 CFR part 201, p.99.

supply natural gas - subject to the provisions of the **Natural Gas Act.**[74] The natural gas companies are classified by the Regulations into four classes, A, B, C and D.[75] Class A has an annual turnover of more than $2.5 million; Class B has a turnover between $1 million and $2.5 million, and Class C a turnover between $1 million and $150,000. For Class D, the upper threshold determinant is $150,000 and the lower threshold a mere $25,000.

The principle seen earlier, of demanding more stringent accounting from companies with a larger turnover, and conversely, is also followed by these accounting regulations for natural gas companies.

(c) Turnover Determinants that Exempt from Duties

US legislation, though seemingly favourable towards small businesses, does not actually exempt them from most of the significant duties that are imposed on bigger businesses. On the few occasions when it does, however, exempt them, it uses the employment criterion in preference to other criteria,[76] most probably because it has been considered easier to justify an exemption that affects only a small number of workers than one that affects a large number, as might conceivably occur if a turnover criterion was applied to a business with many workers and a disproportionately small turnover, such as a fruit-picking business.

The **Fair Labor Standards Act 1938** is the only legislation that has used the turnover criterion in order to define a small business for the purpose of exempting it from fundamental legal duties.

(c.1) The Fair Labor Standards Act 1938

The **Fair Labor Standards Act 1938** is a major piece of legislation: it deals with issues that in 1938 were of great pioneering value. It imposes on employers the duty to pay workers a minimum wage, and

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74 Authority Secs.8(a), 10(a), 16, 52 Stat.825, 826, 830, 15 USC 717g(a), 717(i)(a), 717.

75 18 CFR part 201, p.103.

76 See pp. 224-226.

higher rates for time worked in excess of a maximum hours-per-week stipulation. It is therefore remarkable that employers with a small turnover are exempted from compliance with such fundamental duties.

Sections 13(a)(2), (4), and (11) and Section 13(b)(18) of the Act grant exemption from the minimum wage provisions of Section 6 and the maximum hours provision of Section 7. The turnover criterion is used as a determinant for these exemptions by Sections 13(a)(2) and 13(a)(11) as follows:

Sec. 13(a)(2):

> "Any employee employed by any retail or service establishment (except an establishment or employee engaged in laundering, cleaning or repairing clothing or fabrics or an establishment engaged in the operating of a hospital, institution, or school described in Section 3(s)(4)) if more than 50 per centum of such establishment's annual dollar volume of sales of goods or services is made within the State in which the establishment is located, and such establishment is not in an enterprise described in Section 3(s) or such establishment has an annual dollar volume of sales which is less than $250,000 (exclusive of excise taxes at the retail level which are separately stated). A 'retail or service establishment' shall mean an establishment 75 per centum of whose annual dollar volume of sales of goods or services (or of both) is not for resale and is recognised as retail sales or services in the particular industry."

Sec.13(a)(11):

> "Any employee or proprietor in a retail or service establishment which qualifies as an exempt retail or service establishment under Clause (2) of this subsection with respect to whom the provisions of Sections 6 and 7 would not otherwise apply, engaged in handling telegraphic messages for the public under an agency or contract arrangement with a telegraph company where the telegraph message revenue of such agency does not exceed $500 a month."

The two sections deal with the same exemptions, but refer to two different defineds, one with a turnover of £250,000 per annum and one with $500 per month.

(c.1)a. Section 13(a)(2)

The $250,000 maximum turnover determinant of Section 13(a)(2) is only one of the conditions that have to be complied with before an enterprise can be exempted from the minimum wage provision of Section 6 or the maximum hours provision of Section 7. The other conditions that have to be adhered to are:

a. The employer must be an "establishment".

b. The employer must be a "retail or service" establishment.

c. The employee must be employed "by" the establishment and not merely "in" it.

d. The turnover must not exceed $250,000 per annum.

e. More than 50% of sales must be made "within the State".

(c.1)b. "Establishment"

The employee has to be employed by "an establishment" as distinct from an "enterprise" or a "business".[77] The term "establishment"[78] as used in the **Fair Labor Standards Act** means a distinct physical place of business. Although an "enterprise"[79] may be composed of a single establishment, an "establishment" is not synonymous with the words "business" or "enterprise", when those terms are used to describe multi-unit operations. Many issues have arisen as to what does, and what does not constitute an establishment. Some of the answers to these questions are provided by the regulations themselves. For instance, in a multi-unit operation some of the establishments might qualify for the exemptions, whereas others might not. In the case of a manufacturer with a separate warehouse for storage and distribution, and a few retail shops, the retail shops would be exempted but not the warehouse, because every physically segregated place of business is a separate "establishment". This is the case also with a multiple chain of retail shops, where all units are retail ones, and therefore each such unit is a separate establishment. A store can constitute an "establishment", even though it is departmentalised, because a department within a store is not considered as a separate establishment.[80]

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77 29 CFR Sec.779.303, p.497.

78 29 CFR Sec.779.23.

79 Fair Labor Standards Act 1938, Secs.3(s), 3(r).

80 29 CFR Sec.779.304(a).

(c.1)c. "Retail/Service"

The statutory meaning of Retail or Service Establishment[81] as defined in Section 13(a)(2), is provided by the 1949 Amendment to the Act, which defines the term "retail or service establishment" as:

> "an establishment, 75 per centum of whose annual dollar volume of sales of goods or services (or of both) is not for resale, and is recognised as a retail outlet of sales or services, within the particular industry."[82]

The three tests of what constitutes a retail or service establishment are therefore the following:

a. it must engage in the sale of goods or the provision of services;

b. 75% of its income from sales and/or services must be recognised as retail in the particular industry; and

c. less than 25% of its income from sales and/or services may be sales for resale.

Retail outlets such as a bakery or a fashion shop,[83] where manufacturing might be done at the rear of the premises, raise the question as to whether such an outlet can be considered as a retail establishment. In such cases the test depends on the unity of ownership, and on whether the back room and the front room are operated by the employer as a single store; if they are, then the entire premises will be considered to be a single establishment for the purpose of the exemption.

In situations where on the same premises a concern is carrying out two operations, a retail business and a wholesale one, a distinction between the two needs to be made to obtain the exemptions.[84] A separation will be accepted if (a) the two activities are physically separated from each other by a wall or partition, (b) if each activity is functionally operated as a separate unit with separate records and book-keeping; and (c)

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81 29 CFR Sec.779.312.

82 Wirtz v. Steepleton General Tire Co.Inc., 383 US 190.

83 29 CFR Sec.779.304(b).

84 Ibid., Sec.779.305.

if there is no interchange of employees between the units. This does not mean that an employee from one unit cannot occasionally lend a helping hand to the other unit. The requirements refer to the indiscriminate use of the same employee in both units, without regard to the separate functions of each.[85] Leased departments, or concessions within a large store, are not separate units for the sake of the exemptions.[86]

The meaning of "goods" is defined in Section 3(i) of the **Fair Labor Standards Act 1938**, but the term "services" is not defined by the Act. Therefore the meaning attributed to services is consistent with its usage in ordinary speech, in the context in which it appears, and in the legislative history of the scope of the exemptions;[87] that is, services rendered by establishments which are traditionally regarded as local retail service establishments, such as restaurants, hotels, barber shops, and repair shops.[88]

The ambiguity of what is meant by "retailer" has caused the institution of numerous[89] court proceedings against employers who considered themselves exempt, by employees who did not agree with their interpretation of the exemption. This has prompted the Administration to issue a guiding list enumerating the type of establishments to which the retail concept did not apply.[90] The judicial rulings regarding the interpretation of "retail or services" have clarified somewhat the meaning of the concept and have highlighted some of its particular characteristics. They have declared that the retail or service establishment which sells goods to the general

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85 Ibid.

86 Ibid., Sec.779.306.

87 29 CFR Sec.779.314, p.502.

88 29 CFR Sec.779.315, 779.320.

89 Some 50 cases.

90 29 CFR Sec.779.317, p.503.

public, and serves the everyday needs of the community in which it is located,[91] performs a vital economic function in a country's business organisation at the very end of the stream of distribution, dispensing in small quantities the products and skills of this organisation without taking part in the manufacturing process.[92]

A few items which are not bought for daily consumption, such as small trucks and farm implements, are also considered to qualify for "retail" status, since they are often distributed through stores or showrooms similar to those for consumer goods, and are often used in commercial activities of a limited scope.[93] The determination as to which of such non-typical retail items and/or outlets would be considered as retail establishments is decided on the merit of each case.[94]

Section 779.331 deals with the meaning of "resale", which, except for a specific situation regarding certain building materials, has not been defined by the **Fair Labor Standards Act.** From the courts' decisions,[95] its meaning is understood to be the knowledge of the seller, or his reasonable belief, that the goods will be ultimately resold by the present buyer. Thus, what ultimately happens to the goods or services is immaterial, as long as the buyer had a reasonable belief that the goods were intended for resale. An example to illustrate this point is a case of fire or damage to such goods, which, though rendering them unsaleable to the

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91 This attitude towards small businesses is similar to that of Schumacher, who saw it as a small, non-expanding unit that served the community within which it operated.

92 29 CFR Sec.779.318(a), p.505.

93 Ibid., Sec.779.318(b).

94 Idaho Sheet Metalworks Inc. v. Wirtz and Wirtz v. Steepleton General Tire Co. Inc., 383 US 190.202, rehearing denied 383 US 963.

95 Northwestern - Hanna Fuel Co. v. McComb, 166 F.2d 932 (CA-8); Mitchell v. Duplicate Photo Service, 13 WH Cases 71, 31 LC Par 70, 287 (S.D. Cal. 1956) Mitchell v. Sherry Corine Corp., 264 F.2d 831 (CA-4).

public, has not altered the character of the sale that was made for resale. Similarly if, at the time of sale, the seller did not realise that the goods would eventually be resold, the fact that the goods were eventually resold is not the controlling factor. The term "sale" itself has been defined in Section 3(k) of the Act and includes "any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other dispositions."

(c.1)d. "Employed by"

The employee has to be "employed by" the "employer" who is a retail or service establishment. "Employed by" can mean employment within the establishment or outside it. For example, in order to meet the requirement of actual employment "by" the establishment, in the case of a repair service where the repairers work outside,[96] an employee, whether performing his duties inside or outside the establishment, must be employed by his employer in the work of the exempt establishment itself, in activities within the scope of the exempt business.[97] In **Davis v. Goodman Lumber Co.**[98] it was held that exemption under Section 13(a)(2) was inapplicable to employees working in the manufacturing stages of an employer's retail establishment. Other cases where this principle was repeated[99] distinguished between employed "in" but not "by".[100] Since the exemptions apply to the employees "employed by" the exempt establishment, they cannot be extended to employees who, although working in the establishment, are not employed by it. Thus, auditors, window-

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96 Ibid., 779.307.

97 Ibid., 779.308.

98 Davis v. Goodman Lumber Co., 133 F.2d 52 (CA-4).

99 29 CFR Sec.779.309, p.500.

100 Wessling v. Carroll Gas Co., 226 F Supp. 795 (N.D. Iowa).
Oliveira v. Basteiro, 18 WH Cases 668 (S.D. Texas).
North West Airlines v. Jackson, 184 F.2d 74 (CA-8).
Walling v. Connecticut Co., 154 F.2d 522 (CA-2).
Wabash Radio Corp. v. Walling, 162 F.2d 391 (CA-6).

dressers or sales instructors do not qualify for the exemption, even if they work for the same employer.[101] For example, a manufacturer who sends his employee to give a demonstration at the point of sale of his products, which are being sold by an exempt retail establishment, will not be considered exempt, since the employee is not employed by the retailer, but by the manufacturer. The same would be true for the employee of a central office, who works not at the central office but on the premises of an exempt retail establishment, as in **Mitchell v. Kroger Co.**[102] The employees of employers operating multi-unit businesses[103] may be considered as employed by the exempt establishment, if they are actually employed by the exempt establishment only.[104]

Employees in warehouses and central offices of chain stores are not exempt, despite the fact that they work for a retail establishment, because chain stores are an organisation of a hybrid nature, both wholesale and retail, in which their main warehouses and centralised buying act as a wholesale operation in relation to the individual units.[105]

Employees working in more than one establishment of the same employer[106] are not exempt if they work for an employer who has both exempt and non-exempt establishments, and who employs them in both.

(c.1)e. "$250,000 turnover"

After satisfying the requirements of "establishment", "retail/service", and "employed by", the retail enterprise has to comply with the upper threshold determinant of $250,000 turnover per annum.

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101 Mitchell v. Kroger Co., 248 F.2d 935 (CA-8).

102 Ibid.

103 29 CFR Sec.779.310.

104 Goldberg v. Sunshine Department Stores, 15 WH Cases 169 (CA-5). Mitchell v. Miller Drugs Inc., 255 F.2d 574 (CA-1). Walling v. Goldblatt Bros., 152 F.2d 475 (CA-7).

105 A.H. Philips Inc. v. Walling, 324 US 493. Mitchell v. C & P Stores, 286 F.2d 145 (CA-5).

106 29 CFR Sec.779.311(a).

The "annual dollar volume of sales" of an establishment consists of the gross receipts from all sales of the establishment during a 12-month period, including sales to affiliated enterprises, and before deduction of taxes.[107]

The same methods of calculation apply also to the requirement that 50% of the trade should be done within the State.

(c.1)f. "Within the State"

More than 50% of the $250,000 sales must be made "within the State in which the establishment is located." This limitation was introduced in order to serve as a double check that the exemptions would benefit only small businesses that serve the local community. The only feasible justification as to why those unfortunate employees who worked for the small retail business have to suffer reductions in their minimum wage and overtime rates, while their counterparts in the larger units are earning higher wages, is that the small retail units serve the community, and any increase in their expenditure will automatically be transferred to the consumer.[108]

The determination of whether a sale is made within or outside the State is a difficult one, as a cash-and-carry sale, typical of the majority of retail transactions, will not indicate whether the sale was a local or an inter-State one. But if a delivery was made to an out of State address, or the cheque or credit card had an out-of-State address, it would count as an out-of-State sale. It is difficult to see, however, how the bookkeeping would actually be carried out.[109]

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107 Ibid., Sec.779.342.

108 This very same attitude was expressed by the Fair Labor Standards Act in its Sec.13(b), which exempted the employers of small "country elevators", "small public agencies" and "small employers in the forestry sector" from paying minimum wages and overtime rates. See p. 243-244.

109 29 CFR Sec.779.340, p.515.

The test of whether the sale is made "in" or "outside" the State is the location of the customer. If he is located in the same State as the establishment, then the sale is considered to have taken place within the State; even though such a sale can constitute engagement in inter-State commerce, for example where the sale is made pursuant to prior orders from customers for goods to be obtained from outside the State, or where a sale is made to a customer to be used in inter-State commerce, or in production of goods for such commerce.[110]

(c.2) Section 13(a)(11)

To qualify for the exemption from paying minimum wages and over-time rates, as per Section 13(a)(11), an enterprise has to comply with the following conditions:

a. The employee in question or the proprietor has to engage in handling telegraphic messages for the public.

b. The above occupation has to be carried out in an exempt retail or service establishment as per Sec.13(a)(2).

c. The employee or the proprietor must not be eligible for an exemption from minimum wage and overtime rates, had they not been handling telegraphic messages.[111]

d. The exemption does not apply if the revenue from such telegraphic messages exceeds $500 per month.

The low turnover of $500 per month indicates that the legislator wished to exempt only the small units that serve the very small communities, where in 1938 the telegraph was a vital link of communication. This view is also supported by the provision that the turnover should be calculated monthly and not yearly, because a yearly average would hide the fact that the telegraph was used in a holiday resort by non-residents, during the "season", and not by the local community.

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110 Ibid., Sec.779.341, p.516.

111 Western Union Telegraph Co. v. McComb, 165 F.2d 65 (CA-6).

Summation

The turnover criterion is used extensively by US legislation granting small businesses concessions and assistance; but in the general legislation it is not frequently used. The regulations exempting businesses with a small turnover from some paperwork requirements concentrate only on one sector of the economy, that of "communication", and although this concession has been welcomed, it has not been followed by legislation relating to other sectors of the economy.

Since the numerical determinants of the turnover criterion were first drawn up in the **Small Business Act**'s Regulations, they have been reviewed and re-adjusted, though not regularly; and those that related to the paperwork exemptions have not been updated, so that the number of businesses eligible for exemptions decreases yearly with the increase of the rate of inflation. The reason for the constant updating of the turnover determinants that emanated from the **Small Business Act** is that these determinants form part of a comprehensive system of legislation concerning small businesses, which is equipped with administrative facilities able constantly to monitor the validity of the determinants that grant privileges to small businesses; but such facilities are not available for other, general legislation. The unavilability of such provision for the updating of the turnover determinants might not have been important when the USA was relatively unaffected by the falling value of the dollar, but now that it is falling fast, the issue of updating monetary determinants in legislation, has become urgent.

As regards the exemptions of the **Fair Labor Standards Act**, these relate to the delicate subject of workers' remunerations, and as such it might have been more beneficial to the small business cause if they had not been inserted. A reduction in taxation means a smaller participation in the national burden; less paperwork means less bureaucracy, but the payment of reduced wages to already low-paid working people is an abuse of one's

fellow man. It is in no way a mitigating factor that the exemptions are restricted by conditions and tests, so as to enable only a limited number of small businesses to benefit from them, because in proportion to the small number of employers that benefit from the exemptions, the damage to the image of the small business community is great.

The determinants of the turnover criterion suffer from the same trouble as those of employment: a multitude of different numerical values, each claiming to define a small enterprise. It is self-evident that this state of affairs does not enhance the understanding of the small business sector.

(ii) The Turnover Criterion in the Legislation of the People's Republic of China

Chinese legislators have used the criterion of turnover as the base calculation of the two highest-yielding revenue taxes, the Business Tax and the Commodity Tax, while Income Tax has been levied on profits.[112] Despite the important function of the turnover criterion as a determinant for taxation, it has been used only in its qualitative form without any numerical determinants to distinguish between different-sized enterprises, with the result that the same taxation rates are applied to all enterprises. In itself the lack of quantification is not surprising, since the legislative attitude of the People's Republic of China has been to avoid exactitudes and to rely on generalisations instead.[113]

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112 Income Tax is applied to enterprises as well as to individuals. The latter is referred to as Personal Income Tax.

113 The vagueness and incompleteness of the legislation was complained about by Chinese jurists during the period of relative political freedom in 1957 - the so-called "Hundred Flowers" period. They pointed out the lack of sufficient laws to guide the people, and that the existing ones were full of extremely vague and sweeping provisions. People's Daily, Sept. 15, 1957 (translation).

Usually when the turnover criterion has been used to distinguish between sizes of enterprises, it relies on numerical determinants; since Chinese legislators have in the past avoided the use of numerical determinants, it seems, prima facie, that the Chinese legislation considered here cannot define a small business. This, however, needs to be ascertained, in case the legislation has used other methods to ease the tax burden on smaller enterprises, thus creating an alternative criterion which could constitute their definition.

(a) Provisions on the Simplified Procedures of Tax Payment by State-Operated Enterprises and Co-operatives which Engage in Food Grain Transactions 1955[114]

According to the dictum of affinity between the subject matter of the legislation and the criteria used for its implementation, the Chinese legislator has used the criterion of turnover when dealing with taxes levied on turnover.[115]

These Provisions refer to the criterion of turnover in thier Section 3 as follows:

> "When the commodity tax and business tax are levied on grains in a combined manner the tax rate shall be 4%, on the basis of the State unified sale price in the locality. If no unified sale price exists, the tax may be levied on the basis of the retail price listed by the local State-operated enterprises or co-operatives."[116]

The basis for calculating the turnover is the State's unified sale price in the locality. By "unified sale price" is meant the official price of a commodity according to the price controls that are issued by the Central

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114 Promulgated July 7, 1955.
Chao Kuo-chun, Economic Planning and Organisation in Mainland China, A Documentary Study (1949-1957), East Asian Research Center, Harvard University, 1963, Vol.1, p.235.

115 Li Ch'a, Chung-Kung. The Tax System in the Communist System (1969), as quoted by Thomas W. Huang in "Reflections on Law and the Economy in the People's Republic of China", Harvard International Law Journal, Vol.14, 1973, p.305.

116 Supra, note 114.

Government, and which are not levied on all items,[117] though since 1955 more items have become "controlled". The existence of controlled and uncontrolled items explains why Section 3 offers two methods for calculating the turnover.

The tax is paid only after the sale, and not during the purchase, shipment, storage or processing;[118] and it is levied on the product only once.[119] The difference between the Business Tax and the Income Tax is that the Business Tax is collected from the taxpayers according to their turnover transactions, while Income Tax is calculated as a percentage of the net profit.[120]

Alt hough the tax legislation does not resort to actual numerical determinants, it has managed to create exemptions. For instance, a business is exempted from paying the Business Tax for a certain month if its gross profit for that month was not adequate to cover wages.[121] This exemption links the turnover criterion to the profit one and has in effect transformed the tax on turnover to a tax on profit, by which the enterprises that do not show a profit are exempted from the tax. Another concession given to laggard enterprises is where the gross profit is adequate to cover wages, but inadequate to pay the tax, Business Tax may be reduced or remitted altogether.

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117 The meaning of "price" in Communist China is expressed in the following citation: "The value of a commodity is determined by the amount of socially necessary labor spent in its production. Commodities are exchanged at equal values. The labor spent on the same commodity might be different in different enterprises, so its value would be different. But it is exchanged with other commodities only at the value determined by the amount of socially necessary labor demanded in its production." From "China's Price Policy", China Reconstructs, Jan. 1980, p.21.

118 Sec.4 of the Provisions.

119 Unlike the UK and the Israeli Value Added Taxes, whereby the same product attracts tax at several stages of its route from first seller to last purchaser.

120 New Regulations on Tax Payment by Private Industrial and Commercial Establishments after Transformation, promulgated Aug. 14, 1956, Chao, p.237, supra, note 114, p.362.

121 Ibid.

These concessions contain the principles of a small business definition according to the exclusive method of definition, by which the concession defines its recipient; except that usually the exclusive method of definition relies on quantitative criteria, which are lacking in the present legislation. The lack of determinants as to how much profit would be considered adequate, or how much Business Tax will be exempted, cannot be interpeted as having voided the usage of this legislation, but are explicable in view of the common procedure of "negotiations" between the tax authorities and the enterprises, in which such numerical details are sorted out.

(b) Lack of Quantitative Determinants

It ought to be appreciated that such vague laws do not stem merely from bad legislation, but manifest the overall philosophy of the Chinese legislation, which is based on general guidelines, rather than positive laws. According to the Chinese way of thinking, legislation ought to be flexible, especially for a developing legal system such as theirs.[122]

The legislation of the People's Republic of China abounds with examples of legislation that use qualitative and not quantitative criteria,[123] and although qualitative criteria are considered the more lasting of the two types, the lack of quantifying determinants renders such legislation difficult to implement and even more arbitrary than the arbitrary numerical determinants that constitute the quantitative criteria. One can at least be aware of "numerical arbitrariness", but "qualitative arbitrariness" is utterly shrouded in vagueness.

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122 Philip M. Chen, Law and Justice; The Legal System in China, 2400 BC to 1960 AD, Martin Robertson and Co. Ltd., London, 1973, pp.56, 89..

123 Every quantitative criterion turns into a qualitative one if no numerical determinants are attached to it. This applies also to the typical quantitative criteria such as length, weight etc. A criterion such as length, which is prima facie a quantitative criterion owing to its ability to attract gauging numerical values, becomes a qualitative criterion if such numerical determinants are not available.

Rates expressed in percentages of an unquantified calculation basis and without limiting thresholds,[124] or vague size descriptions without restricting quantifications,[125] are found in most legislative acts of the People's Republic of China. The non-referral to a specific turnover criterion is therefore not an anomaly but normal practice.

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124 a) Labour Insurance Regulations of the People's Republic of China, June 2, 1951, amended Jan. 2, 1953, Article 12(b)(3):
"The amount paid shall be between 10 and 30 percent of his wage prior to being disabled."
The percentage is mentioned; the calculation base, i.e. the wage, is not.

b) Constitution of the Trade Unions of the People's Republic of China, adopted by the Seventh All-China Congress of Trade Unions, May, 10, 1953, Article 33:
"A new member is to pay an admission fee of one per cent of his total wage of the month previous to his admission."
No mention of upper or lower thresholds.
Albert P. Blaustein (ed.), Documents of Communist China, Fred B. Rothman, South Hackensack, New Jersey, 1962, (a) p.539, (b) p.493.

c) The Agrarian Reform Law of the People's Republic of China, as promulgated by the Central People's Government on June 30, 1950, Article 5:
"If the average per capita landholding of such families does not exceed 200 per cent of the average per capita landholding in the locality, it shall remain untouched."
Foreign Language Press, Beijing, second edition, 1951.

125 a) Alternative Articles Concerning the Supply and Marketing Department and of the Credit Department, published by Renmin Ribao on Sept. 4, 1958; Article 7:
"The expenditure incurred plus a small amount of profits."
No explanation of what determines this small profit was provided.

b) Decisions Concerning the Differentiation of Class Status in the Countryside, adopted by the Government Administration Council of the Central People's Government on Aug. 4, 1950: Part III, Sec.5 deals with "small traders and pedlars", yet no definition of small is forwarded.
Blaustein, supra, note 124, (a) p.467, (b) p.322.

c) Directive on the Development of the Handicrafts Cooperatives in Market Towns and Villages, Jan. 5, 1956, issued by the State Council.
Sec.2 refers to "Large (handicraft) producers" without even quantifying the size of "large". (Translated from the Chinese text in the Compendium of Laws and Regulation of the People's Republic of China, Beijing, issued semi-annually from Sept. 1954 to mid-1962, as quoted by Chao Kuo-Chun in Economic Planning and Organisation in Mainland China
Research Center, Harvard University, 1963, p.64.

The value of taxation, besides its obvious function as a provider of finance to governments, is its instrumental role in directing the economy. Where and when necessary, certain industrial sectors or geographical regions can be promoted and encouraged by tax reductions or exemptions, which can be achieved either by quantifying the calculation base of the tax - the turnover or profit criteria - and taxing any part of them, or by altering the tax rate itself. The Chinese have used the second method of taxation in their direction of the economy. They have tampered with the rates, but not with the criteria themselves.[126]

The historic and economic reasons which support the disuse of numerical quantifications of monetary criteria in the legislation of the People's Republic of China are to be found in the crippling hyper-inflation which plagued China before its independence in 1949.[127] In the twelve years from July 1937 to May 1949, the volume of currency issued by the nationalist Koumintang government increased over 140,000 million times, while commodity prices rose over 500,000 million times.[128] It is likely

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126 Examples where reduction in tax rates has been used for the direction of the economy were the following:

a) In 1958 the Agricultural Tax rate was reduced from 15 to 10 % in order to encourage the accumulation of the necessary capital for the development of the communes.
Jean Chesneux, China - The People's Republic, 1949-1976, (trans. from French by Paul Auster and Lydia Davis), The Harvester Press, French publication 1977, English translation 1979.

b) In 1961 private plots of commune members were re-introduced and sideline production was encouraged, by exempting its produce from the agricultural tax.
Jan S. Prybyla, The Political Economy of Communist China, International Textbook Company, Pennsylvania, USA, 1970, p.350.

c) Chinese factories that make profits from products reclaimed from industrial wastes can keep those profits and need not submit them to the State. (The transfer of profits from State owned industries to the State is tantamount to the payment of tax.)
"Factories Can Keep Recycled Profits", news item 020802, Xinhua News Agency, Feb.8, 1980, p.6.

127 Prybyla, p.350, supra, note 126(b).

128 Chou En-Lai, p.2., supra, note 1, p. 339.

that after experiencing such an uncontrollable inflation, it was thought best on economical, psychological and practical grounds to avoid the use of quantifiable monetary criteria, whose real values vary with individual cases and alter with time.

The lack of numerical quantification of the turnover criterion has not impeded the tax authorities in their collection efforts. They can still calculate accurately the expected revenue without it, because the two factors that indicate it - the production figures and the price - are known factors. Production can be assessed quite accurately because China's agricultural and industrial outputs have to perform to pre-set quotas,[129] which, within a certain margin of error and subject to force majeure, are a known quantity; the price is known because prices are predetermined by the authorities.[130]

(c) Summation

Turnover is used in the legislation of the People's Republic of China in the role of a qualitative and not a quantitative criterion. It serves as the calculation base for the Business and Commodity Taxes there, without the numerical determinants that are usually affixed to it. Consequently, the turnover criterion does not define or co-define any group of enterprises, but acts as a general guideline for the levying of taxation. Without its numerical attachments, the turnover criterion cannot and does not define a small business.

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129 Reiitsu Kojima, "Grain Acquisition and Supply in China", Contemporary China, (ed.) Stuart Kirby, Vol.V, 1961-1962, Hong Kong University Press, Oxford University Press, 1963, p.75.

130 Thomas W. Huang, "Reflections on Law and the Economy in the People's Republic of China", Harvard International Law Journal, Vol.14, 1973, pp.289, 291.

The Confucian philosophy has trained the Chinese to prefer unstructured legislation, to choose "mediation" instead of "court" and negotiable tax concessions instead of rigid numerical determinants. Although such an approach might correctly be labelled "vague" and "ambiguous", or "inaccurate", it is nonetheless practical and realistic, as it stems from the attitude that life is not a compendium of laws and regulations to which reality has to adjust, but rather a compendium of different situations and stages to which the law has to be adapted. It is an inevitable result that the Chinese attitudes are inconsistent; yet this inconsistency harbours a great practical compromise with reality, and does not sacrifice it for ideals. In other words, theirs is a pragmatic and not an idealistic approach to life in general and to the law in particular. A pragmatic approach does not put great store on the adherence to rules and regulations which are prey to sporadic changes that render those expected to abide by them the losers, but those enacting them, the winners.

(iii) The Turnover Criterion in the Legislation of the UK

UK legislation has relied on the turnover criterion for its Value Added Tax, in the **Companies Act 1967**, and in the proposals of the **Company Accounting and Disclosure, a Consultative Document** of September 1979. Common to these three compilations is their relatively recent date, the earliest of which was 1967, and the latest 1979.

The infrequent use of the turnover criterion in legislation, in comparison with that of the employment criterion, indicates that it is a more specialised criterion than employment.

(a) Value Added Tax

Value Added Tax[131] is a tax levied on turnover, namely on the total income of any person or enterprise, barring those that are exempted. As befits a law whose subject-matter is tax on turnover, the enabling legislation has used the quantitative elements of the turnover criterion for the creation of upper thresholds to serve as determinants for exclusion from its jurisdiction, or inclusion within one of the assistance schemes for smaller traders.

Schedule 1 of the **Finance Act 1972**, which relates to exemptions from Value Added Tax, fixes the numerical upper thresholds of turnover that determine such exemptions. The Budget of 1980 has amended the aforementioned Schedule 1 of the **Finance Act 1972**, and as from March 27, 1980 has increased the exemption threshold from the previous one of £10,000 turnover to £13,500 per annum. It has also altered the deregistration limit as from June 1, 1980 to become £12,500 per annum, instead of the previous one of £8,500.

The matter at issue in this study is to ascertain whether this exemption threshold of £13,500 turnover constitutes a small business definition. Prima facie that seems to be the case, for what other explanation could be attached to the above exemption, except that it was granted to an enterprise on account of its small size? The reason for the exemption is not necessarily the promotion of small businesses, but might be the cost saving to the tax collector, because the expense of monitoring small revenue resources tends to exceed the revenue collected.

That from the law's point of view the exemption threshold of £13,500 is not a small business definition is evident from its permission to effect "voluntary registration". (Voluntary registration is the application of an

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131 Value Added Tax came into effect in the UK on Apr. 1, 1973. It is contained in the Finance Act 1972, as amended and extended by subsequent legislation.

otherwise exempt trader to be included within the law's jurisdiction.)[132] Had the law intended the exemption to constitute a small business definition, its permission to effect "voluntary registration" would have meant that a small business would have been able to decide that it was not actually a small business, without having exceeded the turnover determinant which had caused it to be classified as a small business in the first place. A business that is small cannot change its size merely by volunteering to be treated as if it were large. Its ability to register voluntarily proves that the £13,500 turnover exemption threshold is not a definition of a small business.

Further evidence in support of the claim that the £13,500 exemption threshold is not a small business definition is provided by the various retail schemes offered by HM Customs and Excise, by which retailers are offered an alternative of keeping a less complicated accounting system than the one usually required by the VAT authorities, in which tax invoices for all inputs (purchases) and outputs (sales) have to be recovered. (The difference between the tax paid on inputs and the tax collected on outputs is the amount due to the Customs by the trader.) For the retailer who sells goods over the counter for cash, such a system is not practical, since no tax invoices are issued, unless actually demanded by the customer.

The simpler book-keeping requirements are offered in the special

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132 The application has to be made on Form VAT 1 together with a letter explaining the reasons, which could be that:

a) he is an exporter and unable to compete on equal terms with his competitors unlesss he can claim deduction in respect of input tax; or

b) his principal customers include registered persons who require tax invoices in order that they may deduct import tax; or

c) he has a genuine and continuing need for registration.

Voluntary registration will enable a person whose turnover is below the specified limit to reclaim VAT paid by him, but will entail his making the required returns to HM Customs and Excise. Once allowed to register, voluntary registration will normally remain in force for at least two years.

schemes for retailers, which are referred to as schemes A, B, C, D, E, F, G, H, and J.[133] Schemes A, B, E, and F apply to all the sizes of retail operations. Scheme J applies only to a large retailer and G and H to a large or medium sized one. Scheme C applies to a retailer whose turnover does not exceed £50,000 p.a., and Scheme D applies to a retailer whose turnover does not exceed £125,000 p.a. The latter two schemes have been designed for the smallest retailers, as their threshold determinants were the lowest. Yet even among the small traders two different sizes of businesses are distinguished, one with a maximum turnover of £50,000 and the other with a maximum turnover of £125,000 p.a. These two thresholds are well above the exemption threshold of £13,500 p.a.

The fact that the Value Added Tax and its authorised schemes designate three different turnover thresholds for small businesses proves that none of these thresholds, including the one that exempts from registration, has been intended to act as a small business definition. It can therefore be concluded that the Value Added Tax provisions do not define a small business in their use of the turnover criterion, with its various numerical determinants.

(b) The Companies Act 1967

The turnover criterion has been used in the **Companies Act 1967** on two occasions, both for the purpose of granting to companies below a certain size exemptions from the fulfillment of specific duties.

A company whose turnover does not exceed £50,000 per annum is exempted from disclosing its export sales,[134] while a company whose turnover does not exceed £1 million is exempted from the duty to disclose its

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133 HM Customs and Excise Notice No.727 and its Supplement explain the workings of these schemes. Each scheme is further detailed in the appropriate Supplement. Scheme A, in Supplement 727A, Scheme B in Supplement 727B, and so on.

134 The Companies Act 1967, Sec.20(1).

turnover in its profit-and-loss account.[135]

Relying on the argument used in connection with the Value Added Tax,[136] - that when a law uses multiple turnover determinants, each for a specific purpose, these determinants are not intended as small business definitions - it is suggested that the turnover criterion of the **Companies Act 1967** should be treated similarly, and should not be considered as a definition of small business.

(c) Company Accounting and Disclosure[137]

The Consultative Document on Company Accounting and Disclosure has already been discussed in connection with the criterion of employment.[138] It is re-introduced in order to investigate the criterion of turnover that constituted one of the three criteria by which the three different sizes of companies were defined.

The turnover threshold that defined the small private company is deemed to be not higher than $1,300,000 per annum. This figure of $1,300,000 is not on its own a definition of a small business, since it is only one of three co-definiing criteria, out of which two have to be complied with. Yet it is a partial definition of a small business for the purpose of that suggested legislation, for the very simple reason that the legislation has expressed its intention that this turnover determinant should be deemed to define a small business.

The meaning of "turnover" was defined a year before the Consultative

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135 The Eighth Schedule of the Companies Act 1967, par.13A(5), amended by Companies (Accounts) Regulations 1971 (SI 1971 No.2044) made under powers of S.454(1); amended by Sec.2 SI 1979 No.1618. The Companies (Accounts) Regulations 1979 came into operation on Dec. 31, 1979.

136 See p. 369.

137 Company Accounting and Disclosure: A Consultative Document, HMSO Cmnd.7654, Sept. 1979.

138 See p.269.

Document was compiled, by Article 28 of the EEC Fourth Directive,[139] which defined "net turnover". Yet Section 1 of the Company Accounting and Disclosure proposals refers to the general term of turnover, without detailing whether it is was a gross or a net one. Therefore, unless revisions to the proposals introduce a different definition of their own, turnover would be presumed to be "net".

(d) Summation

Of the three UK compilations that use the turnover criterion as a definer of different dutiable trades, the Company Accounting and Disclosure proposals is the most important one since, if introduced, it would be the first UK legislation to define a small company according to the positive method of definition by using the turnover criterion as one of its components. Although the proposed definition is to relate only to small companies and not to other legal structures from within which small enterprises operate, it might give a lead for other legislations to follow suit.[140]

As they stand presently, the Company Accounting and Disclosure proposals raise three issues that might become crucial to the definition of small businesses if not resolved. The first relates to the meaning of turnover, whether net or gross, which has not been specified by the proposals; the second is with regard to the transfer of a company from one tier to another, and the third is to do with methods of combating the effects of inflation on numerical determinants.

Whether turnover means a net or a gross one is more of a technical matter and could be resolved by classification; but the second and third

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139 The Fourth Directive was addressed to the EEC Member States in Brussels on July 25, 1978. Its authority stems from Article 54(3)(g) of the Treaty on the Annual Accounts of Certain Types of Companies. Official Journal of the European Communities (No.L 222/11), August 14, 1978.

140 The influence of one legislation on another can be seen in the way that the 1971 small business definition of the Bolton Report, though it has not been adopted by a law, has infiltrated the Administration, and parts of it have been used for the definition of small businesses in connection with Government assistance programmes.

issues are dependent on the economic and juristic outlook of the legislator.

In the case of a transfer of a company from one tier to another, if the deciding determinant is an annual turnover figure, and not for example a biennial average, then it can happen that a company that one year was classified as a proprietary company belonging to the lowest tier might find that the next year it is a large company belonging to the highest tier.[141] On the one hand this might prove that the company was prospering, but on the other hand it might put the company in a situation where it cannot abide by the law as far as book-keeping requirements are concerned, because the concessions for reduced disclosures granted to the proprietary company do not mean only the waiving of the duty to include some extra figures in its end-of-year balance sheet, but also allow a less detailed book-keeping system during the complete year. For such a system to provide all the disclosure details required from the large company is impossible. Had it been possible, it would have meant that the proprietary company did not gain any meaningful concessions at all. If it were proposed to adopt a biennial averaging system, then the first year of accounting would have served as a warning signal, allowing the small company time to re-adjust its book-keeping procedures to its future requirements.

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141 An example would be a proprietary company with a turnover below £1,300,000 and fewer than 50 employees, which over the years has managed to accumulate considerable assets. Thus, though its assets exceed the £650,000 requirement for a proprietary company, it is still eligible for the title of "proprietary" company, since only two out of the three conditions have to be met.

This company decides to utilise its assets, and purchases another production unit, preferably in a labour-intensive field. As a result it can augment its workforce to above 250 and its turnover to exceed £5 million.

If the acquisition is carried out at the beginning of its financial year, the average number-of-employees condition will not be affected by the previous low number of 50. And the turnover would reflect the combined one.

Such a development would change the company's status from small to large within one year.

As regards provisions to cope with inflation, these have not been provided for in the proposals, and it would therefore be presumed that the usual procedure would apply: that is, awaiting the legislator's discretion as to the time and the rate of change of the monetary determinants. It would be up to him to decide if the figures were to be altered at all, whether to keep up with inflation, or as a tool for economic dirigism. When a succeeding legislator is endowed with such discretion, he can divorce the legislation from its previous intention and distort it into uselessness. In terms of the present legislation this would mean that if the numerical determinants were not amended periodically to keep up with inflation, there would develop a discrepancy between the definition of small, medium and large companies and their "real" meaning. If this happened, the law that set out to reform Accounting and Disclosure procedure mainly for the small companies' sake, would ensure that through inflation these would be referred to as large companies and lose all their privileges.

The Value Added Tax provisions used the numerical determinant of the turnover criterion for exemption from the duty to register. The description of turnover, though intended as an "overall" one, in the sense that it includes all the incomes of an enterprise from all its activities, could in cases of incomes from "exempted" activities be construed to cover only part of the turnover. Thus in the case of the £13,500 exemption barrier, if the enterprise had for example £5,000 income from "exempted" activities, the real threshold determinant would in effect be that of £18,500 and not of £13,500.

The legislator has endeavoured to amend the VAT exemption threshold determinants so that they keep up with inflation. Yet these amendments are not a right of the small trader to demand, but a periodic favour endowed by the legislator; and as such, they cannot be relied upon to recur regularly and have been anxiously awaited each year by the small traders, who would

have to readjust their whole mode of trading, if they found that they had ceased to qualify as small businesses.

The turnover threshold determinant relating to the exclusion from the duty to submit a statement of turnover, according to the **Companies Act 1967**, has been increased from £250,000 in 1971 to £1 million in December 1979. It took eight years for the legislator to find the time to acknowledge the need for that amendment, during which time hundreds of small companies for whom that concession was designed, were unable to avail themselves of it, on account of the ravages of inflation.

It seems that the most disturbing aspect of the turnover criterion is the vulnerability of its numerical determinants to the fluctuation of inflation. If this aspect was not that crucial to earlier legislation, drafted at a time of stability in monetary values, now it is becoming more apparent that unless legislation is better equipped to cope with changing monetary values, much of it will cease to fulfill the aims it has been designed for.

(iv) The Turnover Criterion in the Legislation of Israel

For the purpose of defining a small business according to a turnover criterion, it is necessary to take account of the total sales of an enterprise and not only of part of it. As the intention is to establish a distinctive differentiation between one type of business and another, only a comparison of the total turnover of each can achieve it.

Israeli legislation has used the criterion of turnover in two ways: the overall sales of an enterprise, which includes the sales of all its transactions, sections and branches; and the specific turnover of a business relating to an isolated transaction, or only to part of the enterprise's activities, such as exports or imports. Legislation that uses the turnover criterion in the latter manner, as only part of the total, cannot be considered as defining the turnover of a business.

(a) Partial Turnover Criterion

In seven legislative acts the turnover criterion has been used in relation to income derived only from some of the enterprise's activities, and not from all of them. Some measures deal with the turnover from exports and others with that from a specific transaction or a particular division within the enterprise. But even if prima facie this partial turnover criterion might be dismissed as incompatible with a small business definition, these measures should be examined so as to ascertain whether the partial turnover they describe might be an indicator sufficient to differentiate between small and large businesses, in which case it could be used as a definer of small businesses, despite its incomplete coverage of the businesses' sales activities.

(a.1) The Exemption Order (Share Capital Issue) 1943[142]

In this Order the turnover criterion of IL2,500,000 is used as the value of a specific transaction,[143] without relation to the complete income of the enterprise.

(a.2) The Export Order (Exporters' Guarantees) 1959 (5719)[144]

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142 YR 1278 1943 Supplement 2, p.573(70), 675(a).
Amdts.: QT 377, July 23, 1953 (5713), p.1259;
QT 783, Apr. 7, 1958 (5718), p.1013;
QT 841, Nov. 6, 1958 (5719), p. 258;
QT1018, June 9, 1960 (5720), p.1248;
QT2243, June 20, 1968 (5728), p.1761;
QT2270, Aug. 15, 1968 (5728), p.2141;
QT2278, Sept. 5, 1968 (5728), p.2259;
QT2523, Feb. 19, 1970 (5730), p.1045;
QT3286, Jan. 30, 1975 (5735), p. 757;
QT3772, Oct. 27, 1977 (5738), p. 135.

143 Sec.2(1).

144 QT 876, 1959 (5719), p.885. Amendment: QT 1738, 1965 (5725), p.2244.

Here the dollar sales determinants of $100,000,[145] $250,000,[146] and $500,000,[147] are used as indicators of export sales figures, not of total sales. The use of a foreign currency unit as a determinant in Israeli legislation reflects the distrust of the legislator himself for the fortunes of the Israeli currency. Pegging the Israeli pound[148] to the dollar has become an established economic practice there.

(a.3) The Import and Export Order (Possession of Diamonds) 1959 (5719)[149]

This Order is another example of legislation where the export turnover figures have been used as a criterion. In this case the reason for its use was the imposition of an "export licence" tax.[150]

(a.4) The Customs Regulations 1965 (5726)[151]

The **Seventh Supplement of the Customs Regulations 1965 (5726)** dealt with the additional conditions imposed on the issue or renewal of licences for the operation of bonded warehouses, for the purpose of manufacturing[152]; one of these conditions was a turnover exceeding IL-

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145 Secs.1 and 1(1).

146 Sec.1.

147 Sec.1(2).

148 In April 1980 the Israeli pound which was named "Lira" was re-named "Shekel". The "Shekel" was declared to be worth ten old Lirot (pl. of Lira).

149 QT 908 1959 (5719), p.1389.
Amdts: QT 1818, 1965 (5726), p.603;
QT 2949, Dec. 31, 1972 (5733), p. 526;
QT 3268, Dec. 15, 1974 (5736), p. 493;
QT 3453, Dec. 30, 1975 (5736), p. 750;
QT 3686, Mar. 31, 1977 (5737), p.1295;
QT 3851, May 21, 1978 (5738), p.1349.

150 Supplement to Sec.7.

151 QT 1976 (5726), p.274 (as amended); Amended version "DINIM" p.5927.

152 Seventh Supplement, Sec.1.

10,000,000.[153] These turnover figures were expected to reflect only the income from the manufacturing done in the bonded warehouse itself, and not from the total activities of the enterprise.

(a.5) The Registration Regulations (Building Construction Contractors) (Turnover of Subdivisions According to Section 14 of the Law) 1975 (5735)[154]

These Regulations have used the determinant of IL75,000[155] as the turnover criterion of a subdivision within a business, and not of the whole business.

(a.6) The Fruits and Vegetables Products Board's Regulations (Production and Export)(Citrus Products) 1975 (5736)[156]

In these Regulations the determinant of $300,000 export sales is used as a criterion for the granting of a "general exporter's" status.[157] Since this particular turnover criterion is limited only to part of the total marketing efforts of an enterprise, namely the export market, the definition of "general exporter" could not be substituted for a small business definition. The numerical determinant is again related to foreign rather than local currency. Both of these measures that use a dollar determinant in preference to the Lira deal with exports; Israeli currency is not easily exchangeable.

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153 Seventh Supplement, Sec.2(1).

154 QT 3278, Jan. 9, 1975 (5735), p.617.

155 Sec.1.

156 QT 3394, Sept. 8, 1975 (5736), p.4.

157 Sec.1.

(a.7) The Registration Regulations (Construction Engineering Contractors) (Classification of Registered Contractors) 1976 (5736)[158]

These Regulations have used the turnover criterion in connection with the income derived from construction works on a particular site, and not in connection with the total income due to a business from all its construction jobs.[159]

In this legislation the turnover criterion is used only for the partial size definition of an enterprise, and therefore it is unsuitable for consideration as an alternative business definition.

(b) Overall Turnover Criterion

Among the legislations that have used the sales turnover criterion as an indicator of the total sales of an enterprise are the following:

1) **Registration Regulations (Construction Engineering Contractors) (Registration Fees) 1970 (5730).**
2. **The Charitable Trusts Regulations 1974 (5734).**
3. **The Collective Agreements Regulations (Handling Fees to an Employers' Association) 1977 (5737)**
4. **The Income Tax Instructions (Book-keeping) (No.2) 1973 (5733).**
5. **The Value Added Tax Law 1975 (5736).**
6. **The Value Added Tax Regulations (Registration) 1976 (5736).**

Judged by their wide application and consequential importance, these six legislative acts can be divided into two groups, those with limited jurisdictional powers and those with wider ones. The first three belong to the

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158 QT 3570, Aug. 1, 1976 (5736), p.2301.
Amdts: QT 3877, Aug. 3, 1978 (5738), p.1872.
QT 3942, Feb. 8, 1979 (5739), p. 661.

159 Secs.2(a), 2(b).

former group and the last three to the latter. Each of the measures with limited jurisdiction relates to a different economic field; while those with wide jurisdictional powers deal with taxation, and as such they have several common factors.

(b.1) Registration Regulations (Construction Engineering Contractors) (Registration Fees) 1970 (5730)[160]

These Regulations deal with the rates of registration fees for the status of a "Registered Construction Engineering Contractor". The registration fees are levied on the contractors' total turnovers, which are stratified into eight levels, each with its particular threshold determinants.

Although the regulations relate to the complete turnover of enterprises, they are not suitable as a small business definition, because their division of the engineering construction sector into eight levels of turnover is too detailed and cannot be fitted into the small, medium and large classification.

(b.2) The Charitable Trusts Regulations 1974 (5734)[161]

Here a distinction is made between two sizes of charitable trusts,[162] those with an income of less than IL50,000,[163] and those with a higher one.[164] Whether these determinants can be considered as a basis for a small business definition depends on the answers to the following two questions:

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160 QT 2609, Sept. 3, 1970 (5730), p.2220; Amdt. QT 2812, Feb. 24, 1972 (5732), p.690; QT 3134, Feb. 21, 1974 (5734) p.681; QT 3570, Aug. 1, 1976 (5736), p.2303.

161 QT 3135, Feb. 21, 1974 (5734), p.690.

162 Ch.C Secs.11(a)(1); 11(a)(2).

163 Sec.11(a)(1).

164 Sec.11(a)(2).

a) Can a definition that was originally related to a "charitable trust" serve also as that of a business?

b) Is an income criterion synonymous with that of sales volume or turnover?

In order to answer the first question it is necessary to establish if a charitable trust is a business or a non-business. If it is a business, its definition can also serve other businesses; but if not, then its definition cannot be adopted by any organisation except by another non-business.

A charitable trust resembles a business in that both seek an income from outside sources, which are mostly similar, such as the sale of goods, unearned income from property or interest, and government grants. However, there is one source of income that is available only to a charitable trust and not to a business, that is, donations; and it is this that differentiates them despite the fact that both employ workers, have expenditures, and aim at achieving a residue of income over expenses, in other words a profit. What each chooses to do with its profit depends on its individual charters of incorporation, and is in any case an after-effect from its successful performance, irrelevant to its everyday conduct.

Only without the donations element could the income of a charitable trust have been likened to the turnover of a business; therefore, even though the turnover criterion referred to the complete turnover and not only to part of it, it cannot be considered as a small business definition.

(b.3) The Collective Agreements Regulations (Professional Handling Fees to an Employers' Association) 1977 (5737)[165]

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165 QT 3729, June 26, 1977 (5737), p.2025; Amdt. QT 3973, Apr. 26, 1979 (5739), p.1020

These Regulations have already been mentioned in relation to the employment criterion,[166] which the Regulations offer as an alternative criterion to that of turnover.[167]

The figure of IL5 million has been chosen by the Regulations as the borderline between different sizes of businesses. In 1979 IL5 million seemed a low but acceptable upper threshold for a small business, but by the end of 1980 the threshold has become too low to be meaningful in Israel. This is because these Regulations are not subject to an automatic indexation to the rise in the cost of living.

Inflation-prone countries such as Israel accentuate the inherent limitation of monetary criteria, especially if they are to be part of a long term intended definition of small business.

(b.4) The Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)[168]

In these Instructions the turnover criterion is used either exclusively or jointly with the criterion of employment, primarily for the purpose of differentiating between various groups of trades in order to establish the book-keeping procedures required from each. For this purpose they divide the totality of employers into 16 sectors and issue instructions as to the method of book-keeping required from each of them.[169] Within each such sector the industry was divided into groups, each of which had to follow its own book-keeping instructions.

The unique feature of the three taxation laws dealt with in this

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166 See p.322.

167 Secs.3(11)(a); 3(11)(b).

168 The Income Tax Instructions (Book-keeping) (No.2) 1973 (5733) were already mentioned on p.285 in connection with the employment criterion.

169 Each sector was dealt with in a special Supplement of the Instructions.

chapter is the automatic indexation of their lowest turnover threshold to the retail price index.[170] This maintains the determinant at a realistic level in real terms and dispenses with the necessity of involving the legislator in technically detailed legal alterations.[171] The disadvantages of such an automatic indexation of the turnover determinants is the constant vigilance required from traders, who have to ascertain their legal duties and rights time and again, if they are not to break the law. This brings about a heavy reliance on the skills of qualified book-keepers and tax advisors, in addition to the lower clerical functionaries employed by the enterprise itself. This is actually what has happened in Israel, where the complexity of the taxation laws, coupled with the changes imposed by inflation, have led to the unhealthy growth of an unproductive service industry of accountants and tax advisors, out of scale to the size of the economy they service.

(b.4)a. Supplement One - Book-keeping by-Manufacturers

This Supplement divides the sector into six groups of different sizes, three of which are defined exclusively by the turnover criterion, and three by turnover jointly with employment.

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170 The Value Added Tax Law 1975, Sec.126(a), and the Income Tax Instructions (Book-keeping) No.2, 1973 (5733), Sec.2(a).

171 In UK legislation, an exemption from registration and compliance with Value Added Tax requirements is granted in accordance with the appropriate upper threshold of the turnover criterion. Since the UK Value Added Tax legislation does not include an automatic indexation to the retail price index, such a determinant could become out-dated and thus stop fulfilling the function it was designed to accomplish when it was originally introduced. Although the turnover thresholds are altered periodically, they do not keep up with the rate of inflation, and until their alteration they cause unnecessary hardships to those whom the law wished to protect. In this respect, the Israeli system is more functional and appropriate for the present economic climate which is being encountered not merely by countries such as Israel that suffer from very high chronic inflation, but also by less seriously affected vulnerable countries such as the UK and the USA, which nonetheless have not escaped the affliction.

The six different groups are referred to by the legislation according to the size of their turnover, starting with the largest and finishing with the lowest.

Group 1 (Sec.2(a)) defines a manufacturer whose turnover exceeds IL10,000,000.

Group 2 (Sec.2(b)) defines a manufacturer whose turnover ranges from IL4,000,000 to IL10,000,000.

Group 3 (Sec.2(b)) defines a manufacturer whose turnover is below IL4,000,000 but who employs more than 18 workers.

Group 4 (Sec.2(c)) defines a manufacturer whose turnover ranges between IL1,200,000 and IL4,000,000.

Group 5 (Sec.2(c)) defines a manufacturer whose turnover is below IL1,200,000 and whose number of employees ranges between 6 and 17.

Group 6 (Sec.2(d)) defines a manufacturer whose turnover does not exceed I.L.1,200,000 and whose number of employees is five or fewer.

It has already been noted that the groups that are defined exclusively by the criterion of turnover have the highest turnover determinants,[172] and that these categories resemble small business definitions.[173] In the present instance the turnover determinants are not compatible with small businesses, which is not to suggest that there does not exist a correlation between the size of the turnover and the size of the business. Several interesting observations have emerged from studying their inter-relationships, the most significant of which is the small size of the Israeli economy. If the largest group to be considered is one with a turnover above IL10,000,000 (which is equivalent to some £62,500 at October 1980 rates) and the smallest with a turnover of IL1,200,000 (£7,500) then the economy is a very small one

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172 Groups 3, 5, 6. See pp.288-291.

173 Those groups that were defined by the combined turnover and employment criteria were discussed in detail in Chapter Twelve. See pp.288-291.

indeed. Yet first-hand investigations of the Israeli manufacturing sector have indicated that the threshhold determinant of IL10,000,000 turnover at the beginning of 1980 would have meant a medium-sized business and not a large one, and by the end of 1980 it would have meant a small business.[174]

If the largest turnover threshold falls at the level of a small or at the most a medium business, why was it necessary for the legislator to divide the small business sector into five different groups with different book-keeping requirements for each? Furthermore, which of these groups within the small business sector did the legislator himself consider to be a small business?

The answer as to why the small business sector was divided into five groups is to be found in the distrust which exists between the Israeli tax authorities the Israeli small businesses. The origins of this go back to the time when, in a new state without an established tax collecting administration, small businesses got away with minimal book-keeping or even none at all, and preferred to be taxed according to an asssessment by the tax authorities, rather than adhere to a book-keeping system under which they might have been liable to higher taxation. It ought to be mentioned that until the promulgation of the present **Income Tax Instructions** in 1973, book-keeping was not obligatory for most small businesses in Israel.

In order to introduce the small business population to the obligation of keeping accounting books, the book-keeping requirements were tailor made to the estimated abilities of each sectorial sub-division. This might show an attempt on the legislator's part to make accommodations for small businesses, and present them with regulations which they could reasonably abide by, yet it is also noticed that the legislator did not spare any effort

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174 The value of the Lira at the beginning of 1980 was approximately 90 Lirot to the pound sterling, which equated the turnover of IL10,000,000 with £135,000; but by October 1980 it had lost some 56% of its value and was estimated at IL160=£1. This meant that IL10,000,000 equalled £62,500.

in ensuring that the highest possible number of tax-liable enterprises would be subject to the more rigorous bookkeeping requirements. This was done by augmenting the turnover determinant with that of employment, which was to block any loopholes left by the former. For example, the book-keeping requirements which were enumerated by Section 2(b)[175] were to be applied to two groups of traders - to those whose turnover was between IL4,000,000 and IL10,000,000, and simultaneously also to those whose turnover was lower than IL4,000,000, but who employed more than 18 employees. This meant that if a trader thought he could escape the most rigorous accounting procedure by keeping his turnover just below IL4,000,000, he would still be caught in the top group if he employed more than 18 workers.

An attempt to correlate the turnover determinant with that of the number of employees employed by such an enterprise shows incompatibility between them. Yet this could be due to the fact that some of the sub-divisions might have been intended for specific manufacturing patterns within the sector, such as sub-contraction where the manufacturer sells only labour, in which case his number of employees would be high in relation to the low turnover.

The wage structure in Israel at the beginning of 1980 was such that the average earnings of a worker were approximately IL120,000 per year. According to this figure, if the group of the smallest enterprises, No.6,[176] with a turnover of less than IL1,200,000 were taken as an example, it could be calculated that if the undertaking was a manufacturer in the broad sense, implying that it financed the cost of materials as well as that of labour, some 40% of its turnover would account for the purchase of materials and 20% for overheads and expenditure, leaving some 30% - IL400,000-for wages. This sum could enable the business to employ at the

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175 Supplement One.

176 Sec.2(d).

most only three to four employees which, although a low number, fits in with the group's constraints of "five or fewer workers".[177] Yet under no circumstances could the same turnover account for the 6 to 17 employees allocated to the sub-division of group No.5,[178] unless the determinant of 6 to 17 employees was intended for sub-contractors that sold labour only. But even sub-contractors with no expenditure on materials could employ only some six or seven employees, certainly not 17, on their turnover of IL1,200,000.

The conclusion therefore emerges that the legislator has not set out to define the correct, realistic boundaries of a small business; and as it would be too naïve to believe that the tax authorities were incapable of such elementary calculations, one has to accept that the unrealistic correlation between turnover and the number of employees has been introduced in order to guarantee the inclusion of the maximum numbers of taxable undertakings within the stricter book-keeping requirements.

The answer as to which of the five definitions of small-sized businesses is a true small business definition is that none of them is, because the legislator has not tried to define a small business per se, but only to organise its tax-collecting machinery.

(b.4)b. Supplement Two - Book-keeping by Wholesalers

The wholesaling sector is divided into four groups, which are defined as follows:

Group 1 (Sec.2(a)) A wholesaler whose turnover exceeds IL6,000,000[179] or in whose business more than six persons are employed.

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177 Ibid.

178 Sec.2(c).

179 IL6,000,000 at the beginning of 1980 was equivalent to some £70,000, which is a low turnover for a wholesale business with small profit margins in any country, especially if this is considered to be the largest group in the sector. By October 1980 the equivalent sterling value had fallen to about £37,500.

In the definition of this group the employment criterion is offered as an alternative and not as a co-definer with turnover. Consequently there is no correlation between the number of employees and the business's turnover. Being the group with the largest turnover, it is also the one that is expected to comply with the most demanding book-keeping requirements. By fixing a comparatively low threshold determinant, the tax authorities have ensured that a high proportion of the sector is included in the strictest category of book-keeping administration.

Group 2 (Sec.2(b)) A wholesaler whose turnover is between IL2,500,000 and IL6,000,000.

Group 3 (Sec.2(b)) A wholesaler whose turnover is less than IL2,500,000 but who employs 4 or 5 persons.

Group 4 (Sec.2(c)) A wholesaler whose turnover does not exceed IL-2,500,000 and whose business does not employ more than 3 employees.

On the whole, the same suppositions and arguments as advanced in connection with Supplement One apply also to Supplement Two, in particular the reasons for the sub-division of the small business sector into unusually narrow sub-groups. The higher turnover figures and the lower number of employees of the smallest size groups, Nos.4 and 3 of Supplement Two, in comparison with the equivalent groups in Supplement One, can be explained by the nature of the wholesaling business, where the cost of merchandise constitutes a high proportion of the total turnover.

(b.4)c. Supplement Three – Book-keeping by Retailers

This Supplement divides the retail trade into four groups, and defines them as follows:

Group 1 (Sec.2(a)) defines a retailer whose turnover exceeds IL4,000,000 or in whose business six persons are employed.

The alternative employment criterion is similar to that of the No.1 group in Supplement Two, which dealt with the wholesale sector.

Group 2 (Sec.2(b)) defines a retailer whose turnover is between IL2,000,000 and IL4,000,000.

Group 3 (Sec.2(b)) defines a retailer whose turnover is less than IL2,000,000 but has 5 or 6 employees.

Group 4 (Sec.2(b)) defines a retailer who is the owner of a jewellery shop, a perfumery, or a pharmacy, or is an optician, who has a turnover between IL1,000,000 and IL4,000,000 and who has fewer than 7 employees.

The definition of the No. 4 group is a further indication that the legislator has not attempted to define a small business as such, but only to close a possible loophole to such of the named retailers who might claim that they were professional people or craftsmen rather than retailers.

(b.4)d. Supplement Ten – Book-keeping by Vehicle Merchants and Middlemen

This supplement distinguishes between the two principal traders in the vehicle sales sector, merchants and middlemen. The former's size classification is determined by their turnover and the latter's by the amount of their yearly commission. This amounts to the same, as both turnover and commission represent gross income. The middlemen's commission has been calculated at 20% of sales, which equates the turnover determinant of the two types of traders.

This sector has been divided into two groups, each of which is defined exclusively by the turnover criterion, and is accorded a separate set of book-keeping requirements.

Group 1 (Sec.2(a)) defines a vehicle merchant whose turnover exceeds IL10,000,000 or a middleman whose yearly commission exceeds IL500,000.

Group 2 (Sec.2(b)) includes all those who were excluded from the first group, that is, a vehicle merchant whose turnover does not exceed IL10,000,000 or a middleman whose yearly commission does not exceed IL500,000.

For the vehicle business sector, the **Income Tax Instructions** have devised two different sets of book-keeping requirements and have matched each of them with one group of traders. Such a practice of identifying each set of book-keeping requirements with only one group of traders is not encountered in the other Supplements.

(b.4)e. Supplement Elevem – Book-keeping by the Service Industry

Supplement Eleven divides the service industry into four trading groups:

Group 1 (Sec.2(a)) defines a supplier of services whose turnover exceedes IL3,000,000.

Group 2 (Sec.2(b)) defines a supplier of services whose turnover is between IL1,000,000 and IL3,000,000.

Group 3 (Sec.2(b)) defines a supplier of services whose turnover is less than IL1,000,000 but whose business employs five or more persons.

Group 4 (Sec.2(c)) defines a supplier of services whose turnover is less than IL1,000,000 and whose business employs less than five persons.

The definition of the No.4 group is incomplete without the conditions of Section 3,which restricts memberships of the group to the owner of a social hall, or of a hotel, a boarding-house, a holiday camp or a convalescent home;[181] the owner of vehicles used for the transportation of freight or passengers against a financial consideration, including a freight agent who leases out vehicles,[182] or the owner of a garage or a vehicle hire business.[183]

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180 Sec.3(1).

181 Sec.3(2).

182 Sec.3(3).

183 Sec.3(4).

It is of interest to note that the highest turnover specification in the service industries is lower than in any of the other sectors that have been dealt with up to now.[184] The highest determinant of the service sector is IL3,000,000,[185] while that of the manufacturing[186] and car sales[187] sector is over IL10,000,000; that of the wholesale trade is over IL-6,000,000;[188] and that of the retail[189] and building trade[190] is over IL-4,000,000. The only other sector with the same threshold determinant of over IL3,000,000 is the agricultural sector.[191]

There does not seem to be a satisfactory explanation as to why the services and agricultural sectors have been allocated the lowest turnover determinants for the imposition of the strictest book-keeping requirements; nor can a common denominator between these two sectors be found. Once again, it seems that even if the legislator were allowed the benefit of the doubt, and it were assumed that his reasons were justified, such reasons must have originated as the result of some specific experience concerning the bookkeeping capabilities of those sectors, of which only the legislator had exclusive knowledge. Whatever these reasons were, and justifiable as they may have been, they were too specialised for creating a logical, comprehensive base for the legislation which has ensued.

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184 Supplement Thirteen which deals with the "other trader" has a still lower threshold, at IL1,000,000, but as that Supplement is a general one and does not refer to a specific economic sector, it has been ignored as in the present issue.

185 Supplement Eleven, Sec.2(a).

186 Supplement One, Sec.2(a).

187 Supplement Ten, Sec.2(a).

188 Supplement Two, Sec.2(a).

189 Supplement Three, Sec.2(a).

190 Supplement Four, Sec.2(a).

191 Supplement Twelve, Sec.2(a).

It is a fact that a turnover of IL3,000,000, in Israel at the beginning of 1980, constituted a small business. This means that Supplements Eleven and Twelve, which deal with the services and agricultural sectors, have always referred only to small businesses, and not to medium or large ones. This increases the difficulty of using any of their internal size sub-divisions as a small business definition, for lack of factual evidence to suggest which of these sub-groups is more of a small business than the other.

(b.4)f. Supplement Twelve – Book-keeping by Farmers

Supplement Twelve has singled out those farmers whose turnover is derived solely from fruit-growing and defined them according to the area of their holdings;[192] while the other branches of agriculture are divided into four groups, which are defined exclusively according to a turnover criterion.

Group 1 (Sec.2(a)) defines a farmer whose turnover from agriculture exceeds IL3,000,000.

Group 2 (Sec.2(b)) defines a farmer whose turnover from agriculture is between IL1,200,000 and IL3,000,000.

Group 3 (Sec.2(c)) defines a farmer whose turnover from agriculture is between IL1,200,000 and IL1,000,000.

Group 4 defines a farmer whose turnover from agriculture is less than IL1,000,000.

Supplement Twelve, like Supplement Ten, differs from the other Supplements in that:

a) it relies exclusively on the turnover criterion for the definition of each group (except fruit-growers); and

b) it allocates each set of book-keeping requirements to only one group of traders.

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192 Supplement Twelve, Sec.2(e).

Yet despite these common denominators, no similarity of trading patterns can be detected between the vehicle merchants or vehicle middlemen of Supplement Ten and the farmers of Supplement Twelve.

A unique feature of Supplement Twelve is that its No. 3 group has the smallest differential between its lower and upper turnover thresholds. Though such observations might be interesting in themselves, they are too puzzling to be of value in solving the mystery of why the legislator thought it necessary to divide the already small business spectrum of the agriculture sector into smaller parcels still. It is, to say the least, odd that the difference between groups could be a mere IL200,000 (£1,250 in October 1980) because it is absurd to think that the legislator could have believed that any businessman was able to monitor his turnover to such a fine degree as to know beforehand if his turnover was going to be increased or decreased by £1,400 per annum, and gear his book-keeping administration accordingly - let alone when the subject is a small businessman whose business acumen has never been praised. But even if that small businessman were of such acumen as to estimate his turnover fluctuations correctly (possibly as a result of a forward selling policy), it still does not allow for force majeure events which are quite common in the agricultural sector.

It is therefore an inevitable conclusion that the legislator did not understand "business" as such, or even worse, did not try to understand it, and his only concern was the collection of revenue. Furthermore, it is doubtful whether these methods have been the most effective in achieving that target.

(b.4)g. Supplement Thirteen - Book-keeping by Other Traders

Supplement Thirteen includes all the traders that would otherwise manage to escape the widespread net of the **Book-keeping Instructions.** In addition to the usual division into groups, the Supplement has introduced the concept of the "single trader", whose status is determined by combined turnover and employment criteria. The issues relating to the

single trader have been discussed in Chapter Twelve.[193] The rest of Supplement Thirteen deals with all the "other traders".

The concept of the "other trader" is wide and sweeping, in that it includes all the trades and skills with a small number of practitioners, which do not otherwise justify special attention and/or legislation; as well as any future trades which might appear and develop. It is suggested that because of such future uncertainties, the legislator might have thought it best to affix to the "other trader" the lowest turnover determinant, IL1,000,000, as the deciding factor for his inclusion in the group with the most rigorous book-keeping procedures.

Of the three groups which constitute the "other traders", only the one calling for the most demanding bookkeeping duties relies exclusively on the turnover criterion. For the groups with a lower turnover, the employment criterion is added as a co-determinant.

Group 1 defines those having a turnover of over IL1,000,000.

Group 2 defines those having a turnover smaller than IL1,000,000 but employing three workers or more.

How it was possible to have a lower turnover than IL1,000,000 and to be able to pay the wages of more than three employees is not explained.

Group 3 defines those having a smaller turnover than IL1,000,000 and employing fewer than three employees.

The difference between the Nos.2 and 3 groups is only in the number of their employees, since the turnover determinant of both is the same. In other words, the difference between them is that one group employs one extra worker.

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193 See pp. 288-296.

(b.4)h. Summation

Taxation laws seldom use a human factor such as the number of employees, which is alien to the normal concerns of taxation, but usually specify a monetary criterion such as turnover, because it serves as the calculation base for different types of taxations and levies. The **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)** have resorted to the latter in seven of the 16 Supplements which have been issued for the definitions of the book-keeping obligations of the 16 different sectors of the economy. Out of these, two, the vehicle sales and the agricultural sector (except the fruit growers) are defined exclusively by the turnover criterion; however the other five have used the employment criterion too.

The turnover thresholds that imply inclusion in the most rigorous book-keeping category of each specific sector range from a top value of IL10,000,000 minimum[194] to a bottom one of IL1,000,000;[195] and the thresholds that permit inclusion in the most lenient book-keeping categories range from an IL2,500,000 maximum[196] to one of IL1,000,000.[197] The latter threshold was the one more often used.

The affixation of different determinants to the turnover criterion has been practised not only by the Israeli **Income Tax Instructions (Book-keeping)** but also by the US **Small Business Act 1953.** But while in the US Act the reason for this was explained as aiming to ensure a realistic size for the small businesses within their respective sectors, in order to benefit them in their fight for survival against the

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194 Supplement One, Sec.2(a), the manufacturing sector.

195 Supplement Eleven, Sec.2(a), the service sector.

196 Supplement Two, Sec.2(c), the wholesale trade.

197 Supplements Eleven, Sec.2(c); Twelve, Sec.2(d); Thirteen, Sec.2(b).

large businesses, in the Israeli Instructions no similar official reason has been offered, and no logical pattern or rationale has emerged from the maze of varying determinants.

Even the mystical aura which tends to surround irrational acts of legislation, consecrated by a litany of excuses such as "The legislator had his reason", cannot serve as a substitute for the simple proposition that in a country as ridden with tax evasion and bureaucracy as Israel, a simple and undisputed set of instructions on book-keeping administration would have achieved more satisfactory results than the present labyrinth.

(b.5) The Value Added Tax Law 1975 (5736)[198]

One of the criteria used by the **Value Added Tax Law 1975 (5736)** to define a "small trader" is turnover. Owing to the rampant inflation in Israel, the law has provided in its Sections 126(1) and 126(2) that in the case of a "small trader", the turnover determinant is to be geared to the retail price index. In the normal course of events such indexation takes place once a year, on April 1,[199] but as a result of the alarming inflation of 1979, the Minister of Finance has used his authority according to Section 126(2) to update the turnover determinant of a small trader on the August 29, 1979, with a retroactive effect from August 1, 1979. The threshold determinant was effectively raised from IL350,000 to IL1,000,000.[200]

Despite the practical need to update monetary determinants so that they keep up their original significance and intention, such alterations attract criticism for the very same reasons for which they are praised, simply because alterations are taking place at all. This criticism is based on the assertion that such alterations are confusing and give rise to-

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198 SH 791 (5736), p.52. See Chapter Twelve, pp.

199 Sec.126(1).

200 Value Added Tax Regulation (Regularisation of Traders' Turnover Limits) (Amendment) 1979 (5739), QT 4026 (Sept. 16, 1979), p.1888.

instability of definitions. The **Value Added Tax Law**,[201] has tried to protect itself against such criticism by using not only the turnover criterion but also the employment one, by considering two workers, including the owner, to constitute a "small trader". Yet even this addition of an employment determinant has not managed to act as an effective counterbalance to the confusion which arises from the ever-changing monetary determinants of the turnover criterion. The number of two workers, which in 1978 was an approximate equivalent of the previous turnover determinant of IL350,000, does not adjust itself automatically to the raised threshold of IL1,000,000 or to any such future increment, as wages do not necessarily escalate at the same rate as inflation. Consequently the legislator's original definition of 1975 no longer retained its original meaning in 1980.

(b.6) The Value Added Tax Regulations (Registration) 1976 (5736)[202]

Section 13 of the **Value Added Tax Regulations (Registration) 1976 (5736)** enumerates the traders who were not to benefit from the concessions to the "small trader"[203] who is exempted from registering as an "authorised trader", despite the fact that their turnover is below IL1,000,000, and they do not employ more than two workers. The non-exempt traders include: the free professions,[204] such as architects, economists, investigators, technicians, management consultants, tax consultants and accountants; the medical profession,[205] such as doctors, psychologists, physiotherapists, veterinary doctors, dentists and dental

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201 1975 as amended June 29, 1979.

202 QT 3474, Feb. 9, 1976 (5736), p.964, Amdts. QT 3513, Apr. 23, 1976 (5736), p.1416; QT 3576, Aug. 18, 1976 (5736), p.2390; QT 3526, Dec. 1, 1976 (5737), p.439.

203 Value Added Tax Law 1975 (5736), Sec.31(3).

204 The Value Added Tax Regulations (Registration) 1976 (5736), Sec.13(1).

205 Ibid., Sec.13(2).

technicians; an owner of a driving school;[206] an owner of a private educational school;[207] a land merchant or middleman;[208] a vehicle merchant or middleman;[209] a registered company,[210] as per the **Companies Act;**[211] and a co-operative[212] registered in accordance with the **Co-operative Societies Ordinance**[213].

If such a large number of traders are excluded from the exemption, it does not seem that many are allowed to enjoy it. Hence the turnover determinant of IL1,000,000, which gives admission to the title "small trader", has been rendered meaningless, for it applies only to a fraction of the "small traders".

(c) Summation

No measure in Israeli legislation that employs the turnover criterion has used the words "small business" in conjunction with it. Only in two measures, the **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)** and the **Value Added Tax Law 1975 (5736)** is the small business even indirectly alluded to. In the **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)** it is referred to as the "single trader", which infers a small size; and in the **Value Added Tax Law 1975 (5736)** it was mentioned as the "small trader".

The status of "single trader" is aspired to by two claimants. One

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206 Ibid., Sec.13(3).

207 Ibid., Sec.13(4).

208 Ibid., Sec.13(5).

209 Ibid., Sec.13(6).

210 Ibid., Sec.13(7).

211 Israeli Laws Vol.A., p.155.

212 Supra, Sec.13(8), note 204,p.398.

213 The Co-operative Societies Ordinance 1933.

is the trader whose turnover does not exceed IL500,000,[214] and the other is the trader whose turnover is below IL900,000.[215] Adjudicating which of the two traders is the rightful owner of the "single trader" status is secondary to the two main issues that this descriptive title raises. The first is whether a "single trader" is tantamount to a small business; and the second is whether the legislator intended to define a small business and not merely a "single trader".

The settlement of the first issue depends on whether the small business is defined exclusively by a turnover criterion or jointly with other criteria. If it is defined only by the turnover criterion, then it is possible to enumerate situations where the "single trader" exceeds the turnover threshold associated with a small business,[216] which means that the "single trader" is not equivalent to a small business.

Regarding the settlement of the second issue of whether the legislator intended to define a "single trader" or a small business, it is suggested that by his choice of the term "single trader" he has demonstrated his intention. Although it is correct to say that the majority of "single traders" are small, the majority of small businesses are not "single traders". It is therefore unlikely that the legislator would have used the term "single trader" if he wanted to define a small business. The conclusion from these two issues is that the term "single trader" is not a substitute for that of "small business".

As regards the "small trader" of the **Value Added Tax Law 1975 (5736)**, the mere use of the term "small" indicates a closer affinity to the small business than the term "single" of the **Income Tax**

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214 Supplement Thirteen, Sec.1(a).

215 Ibid., Sec.1(b).

216 A successful writer, actor or investor, to name but a few, could exceed the turnover limits of a small business, and still count legitimately as "single traders".

Instructions (Book-keeping) (No.2) 1973 (5733). But because the status of "small trader", like that of "single trader", has two rival contenders, one with a maximum turnover of IL1,000,000,[217] and the other with a maximum turnover of IL40,000,[218] its meaning becomes diffused, and with it its affinity to the small business.

As regards the other legislation that uses the turnover criterion, those measures that use the partial turnover criterion have been dismissed as incapable of defining a small business because the partial turnover[219] does not relate to the total income of the enterprise and therefore cannot indicate its size; and those that used an overall turnover[220] criterion, were dismissed on account of their specific application and their vulnerability to inflation. "Specific application" refers in particular to the taxation legislation, which uses the turnover criterion extensively, but only for the purpose of revenue collection and not in order to define a small business per se.

The emerging picture is that although the turnover criterion has been used by the Israeli legislation to define sizes of enterprises, these definitions are not suitable to serve as a small business definition.

Conclusion

When considering the suitability of the turnover criterion as a definer of small businesses, its use as an exclusive or a joint definer ought to be taken into account, as this bears on its performance expectations. When a criterion acts as a sole definer, it is expected to demonstrate a closer affinity with the defined than when it serves in a joint capacity.

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217 The Value Added Tax Law 1975 (5736), Sec.1.

218 Ibid., Sec.31(3).

219 See p. 376.

220 See p. 379.

The anticipated affinity is of such a degree that if an exclusive criterion is withdrawn, it should not be possible to substitute for it. The same degree of affinity is not expected from a joint criterion that from its inception has not been entrusted with a comprehensive coverage of the defined. Here it is enough for it to define only some of the attributes or characteristics of the defined. These functional differences between the exclusive turnover criterion and the joint one should be considered when deciding its role in the small business definition.

The fact that the turnover criterion is a monetary criterion raises several issues regarding its suitability as a definer of small businesses.

Turnover – With or Without Numerical Determinants

The question of whether it is imperative for a quantifiable criterion to act solely in conjunction with numerical determinants, or whether it is also feasible for it to function in a qualitative mode and act as a guide-line, has not been answered in the same way by all legislators. The three researched countries that subscribe to the "rule of law" philosophy – the USA, the UK and Israel – have invariably used the turnover criterion in conjunction with numerical determinants, because the "rule of law" doc-trine prefers arbitrariness to be contained within the written legislation, (where, rightly or wrongly, it is believed that it is better controlled or even somewhat curtailed) rather than to be entrusted to the lower adminis-trative echelons.

The opposite attitude has been expressed by the legislation of the People's Republic of China, which until recently[221] has regarded the "rule of law" as a capitalist tool used by the property-owning bourgeoisie to hinder the success of the "revolution of the working masses" and to perpetuate their own control. In keeping with this philosophy the Chinese have used the turnover concept as a criterion without numerical attach-ments,[222] so that, when it is encountered in legislation, it appears to be a

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221 About July 1979.

222 See p. 361.

qualitative rather than a quantitative criterion. The result is that blatant arbitrariness is removed from the written legislation, which is left to deal with principles only, and is delegated to the lower rank and file of the Communist Party cadres, who act as the grass-roots administration.

The Chinese legislators seem to have sincerely believed that less arbitrary decisions result from the absence of numerical determinants in prime legislation, and that the affixation of the numerical determinants should be entrusted to the local rule makers, who are acquainted with the prevailing ethnic, geographic and economic conditions of the country. They believed that this system - unlike the "rule of law" system, with its crude and inflexible numerical determinants, insensitive to changing circumstances - is genuinely more just in that it caters for each case individually.

An "overall" or "partial" turnover criterion[223]

For a turnover criterion to function as a definer of a business in general and a small business in particular, it ought to represent the total receipts of the undertaking and not only part of them; for otherwise no reliable picture of the business's activities, and hence its size, can be arrived at. If the turnover criterion is the exclusive definer of a small business, then only the overall turnover can fulfil this task; but where the turnover criterion acts as a co-definer, partial turnover can be considered as well.

From the legislation surveyed in this chapter, it appears that in the USA and the People's Republic of China this criterion has been used only in its overall sense, while the UK and Israel have also used the partial turnover criterion. For example, the UK Value Added Tax has in effect used a partial turnover criterion - though prima facie it does not seem so

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223 See p. 380.

- because its definition of turnover as "the total taxable turnover of all his business activities" does not include income from "exempted" business activities,[224] such as accommodation provided by hotels and boarding-houses to residents who stay longer than four weeks. This implies that the meaning attached to the turnover criterion by the Value Added Tax is only of part of the incomes due to an enterprise, and not all of it.

In Israeli legislation "partial" turnover has not been used in prime legislation but only in specific orders and regulations, for which "partial" turnover might be an appropriate measuring instrument. This indicates that the partial turnover criterion, though useful for legislation dealing with specific aspects of a business, is unsuitable as a criterion for a definition of a type of business.

Indexation of monetary criteria

Being a monetary criterion, turnover is subjected to the fluctuation of inflation. The adverse effects of inflation on the population are not only that it affects their financial standing by leaving them ignorant of their worth, but also that it undermines their legal standing by leaving them in the dark regarding their duties and rights. The adverse effect of inflation on legislation with monetary criteria is that it changes the values of the monetary criteria, and with them the effectiveness of the legislation. For legal systems that are based on consistency, changing monetary values are a great enemy, since a non-consistent legal system is tantamount to no legal system.

Legislators have been aware of the hazards of inflation and have attempted to cope with it by periodic alterations of the monetary determinants so that they keep up with inflation. The alteration of the monetary determinants has been done in two ways. According to one, the current legislator is entrusted with the discretion of deciding the

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224 HM Customs and Excise Notices 700, 701, revised Oct. 1979.

effective date and rate of such a change. In the other method, the date is predetermined by the originating legislator, and the rate decided by the retail price index; as a result the current legislator is left with no discretion as regards the dates and rates of change.

US and UK legislators have almost invariably opted for the method of allowing the current legislator the discretion of imposing the changes to combat the effects of inflation on legislation. The People's Republic of China, which until now has not been confronted with problems of inflation, and in addition practises a legal system in which monetary determinants are allowed greater flexibility than in the "rule of law" countries, has not had to contend with this issue. Its renewed commercial ties with western countries might, however, introduce this problem to them, as inflation is characteristic of free market economies.

In Israel the two methods are practised simultaneously. Most general legislation that uses monetary criteria has to rely on the current legislator for its alterations; but some of the taxation legislation has adopted the automatic indexation method with its mechanism designed by the originating legislator. It is obvious that the legislator's motives for introducing this method into the tax law were in the interests of the revenue authorities, not those of the taxed population. The only benefit accruing to the taxpayers from automatic indexation is that the exemption determinants, where they exist, are raised with the general upgrading of the numerical determinants of the monetary criteria.

Variety of Numerical Determinants

The main problem encountered with monetary criteria is the inconsistency of their numerical determinants. The examples considered above show how these determinants vary not only from one country to another, but also within the country and even within the same legislation. This surely cannot contribute to the reliability of the criterion itself or, consequently, of the definition that uses it. This problem is not unique to

monetary criteria, but is common to all quantifiable criteria such as employment or shareholdings. It is therefore not a question of replacing one quantitative criterion with another, but a fundamental issue of which type of criteria ought to be used, qualitative or quantitative.

Legislators have justified their use of different determinants by claiming that they contributed to flexibility and prevented arbitrariness, because they were adjusted to the specific needs of each economic sector. The USA has based its small business legislation on the erroneous philosophy that because enterprises belonged to different economic sectors, their size determinants, whether of employment or turnover, ought to be determined according to their sectoral affinity. This is to say that the common denominator between one small business and another was to be found within their colleagueship and not within the wider, national or international spectrum of small businesses. This attitude did not take into account the daily interaction of an enterprise with others outside its sector, such as financial institutions, sellers or buyers, nor the commercial advantages gained by knowing the standing of those enterprises that were encountered in everyday dealings. The US philosophy is erroneous in that it has concentrated its "handicap" equalisation process only on internal sectoral factors, for fear that the leviathans might gobble up the small fry, and has forgotten to allow for, let alone classify, external factors which may have just as much effect on small businesses as competition from similar producers.

The turnover determinants in the legislation of the other countries do not display such tremendous fluctuations as in US legislation, simply because it is only the USA that has used these numerical determinants in the positive definition of small businesses. In most other legislations the small business definition has to be deduced from the circumstantial evidence supplied.

Despite its numerous handicaps, the turnover criterion is the most widely used monetary criterion, chiefly because of its "certain" characteristics, which make it a factual and reliable yardstick.

CHAPTER FOURTEEN

VARIOUS MONETARY CRITERIA IN THE LEGISLATION OF THE USA, THE PEOPLE'S REPUBLIC OF CHINA, THE UK AND ISRAEL

Introduction

Apart from the turnover criterion, which is a "certain"[1] criterion, most of the other monetary criteria that have been used in legislation are "uncertain" criteria. Their "uncertainty" might explain their rarer use and their more specific role in legislation. These "uncertain"[2] monetary criteria include such criteria as assets, net worth, common stock issue, equity capital, profit, balance-sheet total, and trading stocks; while the "certain" ones include criteria that are easily verified such as turnover, costs and payroll, which relate to prices.

(i) "Uncertain" Monetary Criteria in the Legislation of the USA

"Uncertain" monetary criteria, as describers of a size and/or type of business have been relied on by three measures in US legislation:

1. The **Small Business Act Size Standards.**
2. The **Internal Revenue Code 1954.**
3. The **Tax Reform Act 1976.**

The criteria used by these legislations are: assets, net worth, net income (profit), stock value (share value) and equity capital.

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1 See p.339.

2 Ibid.

(a) The Small Business Act Size Standards.[3]

The **Small Business Act Size Standards** use three "uncertain" monetary criteria in addition to the "certain" one of turnover; namely, assets, net worth and net income. These criteria have been used as co-definers of small business twice: once in order to ascertain the eligibility of small shopping centres for Small Business Administration loans,[4] and once for eligibility for assistance from small business investment or development companies.[5] In both instances the function of these quantitative criteria is ancillary to that of the qualitative ones of "independently owned and operated and not dominant in its field of operation" that were stipulated by the **Small Business Act** itself.[6]

(a.1) Assets

For a "shopping center"[7] to qualify as "small" and thus be eligible for a loan from the Small Business Administration, its assets may not exceed $8 million;[8] and for a business to be considered "small" and receive financial or other assistance from small business investment companies or development companies, its assets may not exceed $9 million.[9]

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3 Authority: PL 85-536, Sec.5(b)6, 73 Stat.385.

4 Sec.121.3-10(e)(1)(i), 13 CFR, p.258.

5 Sec.121.3-11(a), 13 CFR, p.259.

6 Small Business Act 1953, Sec.3.

7 "Shopping center" was described by the regulations as a "group of commercial establishments planned, developed, owned and managed as a unit with off-street parking provided on the property," Sec.121.3-2(X), 13 CFR, p.245.

8 Supra, note 4, Rev.13; 39 FR 44424, Dec. 24, 1974, as amended by Amdt.3, 40 FR 20951, May 14, 1975; Amdt.5, 40 FR 32825, Aug. 5, 1975; Amdt.13, 42 FR 20457, Apr. 20, 1977; Amdt.15, 42 FR 34864, July 7, 1977.

9 Supra, note 5 , Rev.13, Amdt.5, 40 FR 32826, Aug. 5, 1975.

The criterion of "assets" has been used in its generalised connotation of the total assets of a business inclusive of trading stocks and debtors, and not in its narrower meaning of capital assets. The meaning is in effect "gross assets", exclusive of liabilities.

(a.2) Net Worth

The "net worth" of an enterprise is the residue of its assets over its liabilities or, in other words, its net assets. Both for the Small Business Administration loans for "small shopping centers"[10] and for assistance by small business investment or development companies,[11] the determinant of $4 million net worth acts as a qualifier for a small business status.

(a.3) Net Income

By "net income" is meant "net profit", the residue of profit after taxes have been paid or allowed for. On the two occasions[12] where this criterion has been used by the Regulations, it is not stated as the yearly net income of an enterprise, but as a biennial average. This average is to be computed without the benefit of any carry-over loss. On both these occasions the net income that determined a small business status is fixed at $400,000.

It is interesting to note that although the enterprises subject to these criteria have been allocated different "assets" determinants - one has an $8 million upper asset threshold, and the other $9 million - their "net worth" and "net income" determinants are identical: $4 million and $400,000 respectively. This dispels the possibility of a mathematical relationship between assets, net worth, and net income, and re-emphasises the fact that all these determinants are in effect arbitrary.

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10 13 CFR, Sec.121.3-10(e)(1)(ii).

11 Supra, note 5, p. 409.

12 (a) Sec.121.3-10(e)(1)(iii) 13 CFR, p.258; (b) Sec.121.3-11(a) 13 CFR, p.259.

(b) The Internal Revenue Code 1954

Section 1244 of the **Internal Revenue Code 1954** allows an individual or a partnership to consider a capital loss as a trading loss, if such a loss is incurred from the sale or worthlessness of common stocks of a small corporation. Since the concession is linked to small corporations, their definition is required in order to activate the concession.[13]

The two monetary criteria used by Section 1244 for a small business determination are "common stock issue" and "equity capital".

(b.1) Common Stock Issue

For a corporation to qualify as a small enterprise it is allowed to issue common stock only to the value of $500,000.[14] When such stock or a part of it is issued against property and not for cash, the value of that property is to be assessed at its fair market value, and not at its book value. On the other hand any liabilities to which that property was subject were deductible, as were liabilities assumed by the corporation in the process of that stock issue.

(b.2) Equity Capital

By the equity capital of a small business corporation is meant the total value of its common stock, and not just the value of a specific stock issue. The equity capital of a small corporation is not to exceed $1,000,000.[15]

The distinction made by Section 1244 between the value of a single stock issue and that of the total equity capital is of relevance in two situations:

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13 Internal Revenue Code 1954, Sec.1244(C)(2)(A)(ii) and Sec.1244(C)(2)(B)(ii), as added by Sec.202(b), Small Business Tax Revision Act 1958 (72 Stat. 1676).

14 Internal Revenue Code, Sec.1244(C)(2)(A)(ii).

15 Ibid., Sec.1244(C)(2)(B)(ii).

(a) when the stock issue itself, though small, i.e. under $500,000, is issued by a large corporation whose equity capital exceeds $1 million, which if judged only by the criterion of stock issue could be mistaken for a small enterprise; and

(b) when a small corporation, despite its relatively low equity capital of under $1 million, successfully issues stocks in excess of $500,000, thus aggregating its initial equity capital and its new stock issue to exceed the maximum of $1,500,000 worth, which is the combined value of the equity capital and the additional stock issue allowed to a small corporation under Section 1244.

(c) The Tax Reform Act 1976[16]

The **Tax Reform Act 1976** is considered the most far- reaching tax revision legislation since 1954, in particular with regard to tax concessions for the smaller corporations. It continues with the tax reduction trends set by the **Emergency Tax Reduction Act 1975**,[17] which was prompted by the "most severe recession since the Great Depression",[18] and which increased the corporate surtax exemption from $25,000 to $50,000 for 1975, and provided a reduction in the normal corporate tax rate from 22% to 20% on the first $25,000 of net income.[19]

(c.1) Profit

The **Tax Reform Act 1976** has used the criterion of profit for determining the tax liability of corporations that show a profit.

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16 Promulgated Oct. 4, 1976, HR 10612.

17 Emergency Tax Reduction Act 1975, PL 94-12, 94th Congress, First Session, approved Mar. 29, 1975.

18 26th Annual Report of the Select Committee on Small Business, United States Senate, for the 94th Congress, First Session, Feb. 19, 1976, U.S. Government Printing Office, Washington, 1976, p.73.

19 These provisions were incorporated into the Emergency Tax Reduction Act 1975 by S.1119.

Prior to the **Emergency Tax Reduction Act 1975**, only one stratum of profits attracted reduced tax rates - that of corporations with less than $25,000 profits - but since then two strata now attract lower tax rates: the aforementioned one of below $25,000 profits; and another with profits between $25,000 and $50,000. Thus if before the **Emergency Tax Reduction Act 1975** it might have been possible to claim that the profit determinant of $25,000 was in effect a definer of small businesses, the introduction by the Act of a further profit determinant of between $25,000 and $50,000 has voided such an argument. However, it might be maintained that the upper threshold of $25,000 profit related to small businesses; the one of $50,000 to the medium-sized enterprise, and profits above this figure represented the large corporation.

These arguments could have been accepted, had actual large corporations not shown time and again that low profits are not unique to small and medium enterprises, but are also experienced by them. Because the tax concessions on lower profits are available to all sizes of corporations, and not only to small ones, the profit criterion disqualifies itself from being a definer of small businesses.

(ii) "Uncertain" Monetary Criteria in the Legislation of the People's Republic of China

Although the legislation of the People's Republic of China recognises such concepts as assets, capital assets and profit, it does not use them as qualifiers of a size or a type of enterprise. Hence no quantitative definition of a small business can result from the mere use of these concepts without their quantified determinants.

(a) Assets

The concept of assets has been used by Article 6 of the **Provisional Regulations on Public-Private Jointly Operated Enter-**

prises.[20] The "uncertainty" of a concept such as assets is demonstrated by this Article:

> "The real assets of enterprises should be assessed through consultations by public and private parties on a fair and reasonable basis, taking into consideration how long the assets will actually continue to be serviceable and the effect of the assets on industrial production of the enterprise concerned."

The conclusion that emerges from this Article is that the value of assets is established through a process of negotiations. This holds true not only as regards the People's Republic of China but also as concerns such developed industrial countries as the USA and the UK. Negotiations need not be only a low-level process of bargaining between the authorities and the taxpayers, but could take the form of a complex negotiation in which each party puts forward its own valuation of the assets involved.

The worth of an asset is a negotiable value, because it relies on other factors other than its original cost or present market value, such as its specific worth to the owner. Because of the complex considerations involved in determining the worth of an asset, it is correct to classify an "assets" criterion as "uncertain". The numerical quantification of "uncertain" criteria does not render them "certain", but merely more arbitrary. Thus it might have been wise on the part of the Chinese legislator to have refrained from attempting to quantify "uncertain" criteria.

(b) Profit

The criterion of profit is mentioned by Article 17 of the **Provisional Regulations on Public-Private Jointly Operated Enterprises,**[21] in connection with the payment of Income Tax which

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20 Promulgated Sept. 2, 1954; Chao Kuo-Chun, Economic Planning and Organisation in Mainland China, a Documentary Study, 1949-1957, East Asian Research Center, Harvard University, Vol.1, p.72.

21 Ibid., p.74. Article 17: "The balance of yearly profits after payment of income tax should be distributed by the jointly operated enterprises among reserve funds..."

was levied on profits; and by the **Report on the Problem of Adjustment of Taxes,**[22] which refers to the payment of income tax on business profits. Apart from these superficial references to the criterion of profit, no details of how it is to be calculated are given in these two documents.

The **New Regulations on Tax Payment by Private Industrial and Commercial Establishments after Transformation**[23] shed somewhat more light on the function of the profit criterion in the Chinese legislation. Business Tax is paid on gross profit, whereas Income Tax is paid on net profit, which is calculated as follows:

> Net profit = actual gross profit, less expenses. The expenses are computed according to the expenses fixed by the State commercial establishments and supply and marketing co-operatives for different trades.

Furthermore, the **New Regulations on Tax Payment by Private Industrial and Commercial Establishments after Transformation** single out small enterprises with low profits for partial or total exemption from taxes. Yet the determinant of what is meant by low profits is not expressed in figures but by a qualitative criterion such as: insufficient gross profits for the payment of wages, inadequate gross profits to pay tax; or inadequate profits for a continued viability of the business.

The **Regulations on the Administration of National Taxation**[24] refer to tax payment by State and privately owned enterprises. Section 8 of the Regulations establishes that the tax is

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22 Ibid., p.227, Promulgated June 15, 1950.

23 Ibid., p.237. Promulgated Aug. 14, 1956.

24 Ibid., p.226. Promulgated Jan. 31, 1950. For the purpose of unifying the national tax administration, the Communist Party Government held a national taxation conference in Peking in November 1949. The present regulations resulted from that conference.

paid on profit.[25]

As to other monetary criteria, such as share issues and equity capital, these do not appear in the Chinese legislation, for the non-existence of a market for the free transfer of stocks and shares renders such criteria inapplicable.

(iii) Various Monetary Criteria in the Legislation of the UK

UK legislation uses the monetary criteria of profit, payroll and balance sheet total, in addition to that of turnover, for the description of commercial enterprises that attract different sets of duties. The "uncertain" criterion of profit serves as the calculation base for Corporation Tax; the "certain" criterion of payroll determines liability to Training Levy; and the "uncertain" criterion of balance sheet total decides a company's tier, according to the **Company Accounting and Disclosure** proposals.[26]

(a) Profit

Profit is the basis for the levying of Corporation Tax, which was introduced by the **Finance Act 1965.** Until 1972, all levels of companies' profits were taxed at an equal rate, and therefore the criterion of profit was not required to function as a definer of a company's size. The **Finance Act 1972** refers to small companies in its Section 95(1), which introduces the concept of the "small companies rate" which is to apply to certain levels of profits as Parliament may from time to time determine. From March 31, 1980, companies whose profits do not exceed £50,000 will be taxed at 40%.

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25 Profit is referred to as the "independent capital" of the enterprise, which is what it actually is, as it is the only capital that was generated independently by the enterprise itself and not injected by outside resources.

26 Company Accounting and Disclosure: A Consultative Document, HMSO, Cmnd. 7654, Sept. 1979, p.1.

The **Finance Act 1972**[27] determines the size of a company according to its profit levels. This means that companies which according to other criteria such as employment or turnover are considered large can benefit from the reduced tax concessions which were originally introduced for the small companies, as long as their profit level satisfies the Act's requirements. The Act's correlation of low profits with low taxation rates was not necessarily intended to constitute a small business definition; and the two references made by the Act to "small companies" do not implicitly define them. The first reference is made in the title of Section 95, "Mitigation of Corporation Tax Liability of Small Companies" - a mere mention without any attempt at definition. The second reference is made in Section 95(1) "... (to be known as the small companies rate)...", which infers that the definition is of the "rate" and not of the small company, because it is the "rate" that is to be known as the "small companies rate" and not the type of company that is to be known as "small".

Thus it would seem that the **Finance Act 1972** defined only a taxation rate for small companies, and not a small company per se.

(b) Balance Sheet Total

Company Accounting and Disclosure: A Consultative Document,[28] uses the balance-sheet total as one of three quantitative criteria in the definition of small private companies, of which only two have to be complied with.

Balance-sheet total means the net assets of a company inclusive of its share capital value, assets and accumulated profits, less outstanding liabilities. For the definition of small private companies, the sum of

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27 Sec.95(1).

28 Supra, note 26, p.416.

£650,000 balance-sheet total is deemed to represent the maximum level. Like profits, this criterion is classified as "uncertain" because of the complexity in ascertaining its true worth. Although the Consultative Document goes into great detail to devise standard accounting procedures, it does not eliminate the problem of subjective assessment and valuation which affects the balance sheet total criterion.

(c) Payroll

Payroll is used as a criterion for determining the exemption of enterprises from the compulsory training levies imposed by the Industrial Training Boards[29], usually at the rate of 1% of the enterprise's payroll, calculated over a base period. In some industries the liability is decided in accordance with the number of employees at a specific date, and not according to their payroll.[30]

Of the 24 Industrial Training Boards, 13 based the exemption from levy on the payroll criterion, seven on employment and three on payroll or employment, while one had no exemptions. Both criteria, employment and payroll, are "certain" criteria since they are easily verifiable in absolute terms.

(iv) Various Monetary Criteria in the Legislation of Israel

In its differentiation of types and sizes of enterprises, Israeli legislation uses the following monetary criteria in addition to turnover: building costs, business stocks and payroll. The criterion of building costs is used by the **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733),**[31] that of trading stocks is used by the **Business Licensing**

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29 The imposition of the Training Levies was authorised by the Industrial Training Act 1964, as amended by the Employment and Training Act 1973. The exemption was authorised by Sec. 7(1A)(a) of the 1964 Act.

30 See pp.368-372 and Appendix 1.

31 QT 2958, 1973 (5733), Jan. 2, 1973, p.626.

Order (Businesses Requiring Licensing),[32] and payroll is one of the criteria employed by the **Value Added Tax Law 1975 (5746).**[33]

(a) Building Costs

Supplement Four of the **Income Tax Instructions (Book-keeping) (No.2) 1973 (5733)**[34] allots different book-keeping procedures to the building sector in accordance with the building costs incurred by the contractors.

Building costs are defined[35] as the total cost of materials, sub-contraction, wages and other direct expenses relating to the building work, inclusive of the depreciation of machinery and equipment used for building and of the cost of the land.

The building contractors are divided into three groups according to whether their building costs exceed IL4 million, range between IL1 million and IL4 million, or do not exceed IL1 million. The most demanding book-keeping is required from the group with the highest building costs. This group is defined only according to the criterion of building costs; however the second and third groups are defined also by the employment criterion.

Although building costs might seem to be a "certain" monetary criterion,since many of their components are verifiable accurately, it is in effect "uncertain" because it also includes factors such as depreciation and the cost of land, which have to be correlated to market values, and are therefore essentially uncertain.

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32 QT 2963, Feb. 1, 1973 (5733), p.684.

33 Promulgated on Jan. 6, 1976 SH 791, p.52, Amdts.: SH 877, Dec. 8, 1977, p.36; SH 879, Dec. 30, 1977, p.46; SH 921, Jan. 4, 1979, p.32; SH 927, Feb. 16, 1979, p.52.

34 Supra, note 31, p.418.

35 Income Tax Instructions (Book-keeping) (No.2) 1973 (5733), Supplement Four, Sec.1.

The legislator's motive for having chosen costs and not sales as the determining factor of an enterprise's size must have been the fact that many building projects take longer than a year to complete; and therefore the sales figure cannot provide an accurate account of the financial standing of a businesss, since the cash flow is low but the asset appreciation is high. Because costs can be aggregated for fixed periods of time, they can reflect the size of the enterprise's activities during the financial year, if not its actual revenue. For the tax authorities the criterion of costs is an appropriate one for the building industry, but as a general criterion for the definition of small businesses it is too specific.

(b) Trading Stocks

The Supplement to the **Business Licensing Order (Businesses Requiring Licensing) 1973 (5733),**[36] uses the criterion of trading stocks in connection with the licensing of businesses dealing in fabrics,[37] metals,[38] skins, furs and carpets.[39] For all these businesses the determinant of IL500,000[40] is the decisive factor for their licensing requirements. Those with stocks worth in excess of IL500,000 require a trading licence, whereas those whose stocks are valued below this sum are exempted from this requirement. The valuation of the stock was done in accordance with their insured value; that is, the value declared by the insured to the insurers was accepted as the stock's actual value.

The Order mentions 187 types of businesses that require a licence,

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36 Supra, note 32, p.419, as per Business Licencing Act 1968 (5728), Sec.1(a)(2).

37 Item 101.

38 Item 125. "Metals means only copper, brass, bronze, lead and pewter.

39 Item 128.

40 In 1973 IL500,000 was approximately £18,000.

but the criterion of trading stocks is used only for the three types of businesses mentioned. Thus, although the determinant of IL500,000 of trading stock does differentiate between the size of one business and another, it cannot be accepted as a meaningful definition of small business. It can only be construed as having been chosen in the light of specific local trading conditions which necessitate this very specific distinction between businesses whose trading stocks are worth less or more than IL500,000.[41]

(c) Payroll

The **Value Added Tax Law 1975 (5736)**[42] uses the payroll criterion as a measurement of size in financial enterprises and non-profit-making organisations.[43] These types of businesses are exempted from paying Value Added Tax,[44] but have to pay a Wages Tax which is imposed as a percentage on the payroll of the enterprise.[45] Smaller financial enterprises and non-profit-making organisations, whose payroll does not exceed I.L.96,000 are exempted from Wages Tax as well.

The criterion of payroll, like employment, when used for the description of small businesses, can produce anomalies: it can happen that a business with a large turnover and high profits shows low payroll figures, where the nature of the business does not involve a great number of employees. Nevertheless, the payroll criterion is a "certain" one, and is considered a reliable criterion which can be used for differentiation between sizes of enterprises. Israeli legislation uses it only for two types of enterprises, financial and non-profit making organisations. Among these

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41 The order has not provided for inflation. Consequently the IL500,000 that in 1973 were equivalent to some £18,000 were worth only £3125 in October 1980.

42 Supra, note 33, p. 419.

43 Sec.35 of the Value Added Tax Law 1975; Amdt., Apr. 1, 1978, YP 2362, 2443, SH927.

44 Sec.4.

45 Sec.4(b).

non-profit-making organisations, which were defined as institutions without intentions of profit making,[46] were included the State, local authorities, non-profit making corporations, and corporations established by law.[47] The close links that the payroll criterion has with the non-commercial sector of the economy prevent it from becoming a popular criterion in the definition of small businesses in Israel.

Conclusion

Monetary criteria other than turnover have not been popular with legislators, as judged by the few instances in which they have called into play the definition of different types of businesses and traders. The only available explanation for their infrequent use is the "uncertainty" attached to most monetary criteria. The criteria of assets, net worth (balance-sheet total), profit (net income), equity capital, payroll, building costs and trading stocks have been used variously by the legislations of the four researched countries. It would be illuminating to find out the reason why each of these criteria has been chosen in preference to another.

The US legislator has chosen the trio of assets, net worth and net income for the definition of only two types of enterprises - shopping centres and small business investment corporations, but he has chosen the criterion of turnover for the definition of hundreds of other types of businesses. Why was it that these two businesses have to be defined so totally differently, and what makes them so unique? While it is impossible to forward an objective answer to this question, a subjective one does exist. The anomalous use of these criteria by the **Small Business Act Size Standards** has resulted from the original purpose of segregating

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46 Sec.1.

47 Ibid.

small businesses from the larger ones so that they may be assisted and fortified to withstand competition.

Once the upholding of competition is identified as the reason for the promotion of small business, it is only logical that comparison between sizes of enterprises should be done individually for each type of industry. As a result the criterion to determine "smallness" and the numerical values to quantify it have been decided in accordance with what has been believed to be the most suitable criterion for a specific sector, even if it is incongruous with the general structure of the legislation, because the aim of the **Small Business Act Size Standards** is to determine the meaning of "small" within a specified industry, and not within the totality of the business community.

The amount of common stock issue and the amount of equity capital are the criteria used by the US **Internal Revenue Code** for the definition of a small corporation. These are specific criteria designed for specialists only, since usually they are too complicated to be worked out by the trader whom they define. The **Internal Revenue Code** intended to encourage investment in small corporations by allowing the investor's capital loss to be considered as a trading loss; and for that purpose it had to define small corporations. The criteria that are used for the definition of the small business are for a very particular situation, and their wider applicability would depend on the existence of a "market" in private stocks and shares, the absence of which would exclude the use of these criteria for many countries. Consequently these criteria are not suitable as general definers of small business.

The criterion of profit is used by the USA legislation once in the form of "net income" in the **Small Business Act Size Standards**, and once in the **Tax Reform Act 1976.** In the **Tax Reform Act 1976** it is used similarly to the way it is employed in the legislation dealing with

both the UK Corporation Tax and the People's Republic of China Business Tax - that is, to concede a reduced rate of taxation to enterprises with a low level of profits. In the USA and the UK, this concession is granted only to companies and not to unincorporated bodies; but in the People's Republic of China, where no such distinction exists, the tax reductions apply mainly to private undertakings which, owing to their small size, are more likely to suffer from low profit levels than are bigger enterprises.

Profit, as a differentiator between sizes of enterprises, is not used by Israeli legislation since, owing to the small size of the economy and the multitude of small businesses, the rate of taxation is the same for all profit levels; such a concession to small business might result in a severe loss of revenue to the authorities.

The criterion of assets is sometimes referred to in the connotation of "gross assets" and sometimes of "net assets". The US **Small Business Act Size Standards** use both types of assets. Gross assets are referred to simply as "assets", and net assets as "net worth". In the legislation of the People's Republic of China it is not clear whether assets mean "gross" or "net"; but it is likely that the intention is "net assets", as "gross assets" are not in effect real assets because they also include liabilities. The proposed UK legislation for **Company Accounting and Disclosure** uses the net asset criterion under the name of "balance sheet total".

The concept of "assets", whether in "gross" or "net" form, is a complicated one to use in a definition of a type or a size of a business, because very often it does not reflect the actual state of affairs in the business. This has been shown by the many professional asset-strippers who exploited the "small" mentality of asset-rich companies that did not realise the value of the assets they owned. Thus companies that according

to the worth of their assets were large, proved to be small ones according to the nominal worth of their capital, the number of their employees, their turnover or their profits.

The criterion of payroll has been used by UK and Israeli legislators for the purpose of imposing taxation. In UK legislation the relevant tax is a Training Levy, whereas in Israel it is a Wage Tax, which serves as a substitute for the Value Added Tax that is not imposed on certain enterprises.

The criteria of building costs and trading stocks are found only in Israeli legislation; they are considered too specialised to be of value as definers of small business.

The various monetary criteria used by the legislations of the four researched countries have proved to be mostly "uncertain" ones and, as such, ought if possible to be avoided as general definers of phenomena.

CHAPTER FIFTEEN

THE OWNERSHIP CRITERION IN THE LEGISLATION OF THE USA, THE PEOPLE'S REPUBLIC OF CHINA, THE UK AND ISRAEL

Introduction

Both aspects of ownership, the qualitative and the quantitative have been used in legislation for the description of small businesses. Its qualitative nature has been stipulated by the various small business definitions that insisted on the need for correlation between ownership and management,[1] without regard to the legal form of trading which the business had adopted; and the quantitative details of ownership, namely the number of its owners, have been linked by the various legislations to its size, via the legal pattern of its trading.

The following six forms of trading will be dealt with: sole ownership, partnership, corporation, co-operative, commune and kibbutz. Out of these, only the first, sole ownership, relates to a single owner, while the others deal with the relationship and numbers of co-owners. The emphasis, therefore, is on co-ownership rather than ownership, and so it is the quantitative aspects of ownership that will be explored, rather than its qualitative ones.

Of these six patterns of business, sole ownership is the most basic and least complicated, because single ownership avoids the inevitable complications which arise between participants. As a result the legal restrictions and demands imposed on the single owner are less exacting

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1 The ownership/management criterion has been used by:
a) The USA Small Business Act 1953, see p.88.
b) The UK Bolton Report, 1971, see p. 142.
c) The Chinese official press, Beijing Review July 13, 1979, p.4, see p.110.
d) The Israeli Advisory Small Business Centre, see p.148.
e) The German Guidelines for Structural Policy, see p. 146.
f) The Italian Artisanat Law No. 860, July 1956, see p.167.

than those imposed on the other forms of ownership,[2] and therefore the sole ownership form of business in countries that offer sufficient alternative patterns of trading will not be elaborated upon. Sole ownership will, however, be examined in relation to the People's Republic of China, for there it is only one out of two existing legal forms that can be utilised by small businesses.

As great similarity will be encountered between some of the co-ownership forms of the UK, the USA and Israel owing to the fact that the latter two follow the English legal system, it is hoped that the dissimilarity of the Chinese trading forms will act as a revitalising catalyst in evaluating the suitability of these business patterns for the operations of a small business.

(i) The Ownership Criterion in the Legislation of the USA

In the USA, shared ownership has been dealt with by the laws of commerce and of taxation, each of which relies on different numerical determinants to decide the size of an enterprise, and with it its duties and/or rights. Because the two branches of the law have different opinions regarding the relationship between size and the number of owners that constitute a small business, they have been operating disharmoniously on parallel levels, meaning that the number of owners that was considered by one to qualify as a small business was not necessarily accepted by the other to mean the same.

Originally, according to the definition of commercial law, neither the partnership nor the corporation and their related forms of

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2 Some of the trading restrictions imposed on the sole proprietor are: the need to register a business name if he trades under any other name but his own surname, according to UK law; and the need to acquire a trading licence if the trade and location so require, according to the laws of the USA, People's Republic of China, UK and Israel.

trading[3] were restricted in the maximum number of their owners. The first tiering of a legal trading form in accordance with the number of its owners was introduced by the Law of Taxation with the inauguration of the "personal holding company" in 1954. This was followed by the "elected small business corporation" in 1958, which is also referred to as the "closely held corporation". The contribution of commercial law to the correlation between number of owners and the uniqueness of the enterprise is the "close corporation", which has been introduced only recently and gradually by the different States.

Until now no agreement has been reached between the different States as to the existence of the concept, its meriting legislative attention, or the number of owners that constitute such a close corporation. While no disagreement exists as to the meaning or number of owners of the personal holding company and the elected small business corporation, because these were introduced by a Federal tax legislation, the definition of the close corporation is still being debated because it is a creation of commercial law, which is legislated by the individual states, a fact that does not promote a consensus of opinion. As a result, a corporation that according to the tax definition is "closely held" might find that it is a public corporation as far as the domicile law of its incorporating State is concerned.

(a) Forms of Joint Commercial Ownership in the USA

In addition to sole ownership, the following forms of business ownership prevail in the USA:

The partnership, which is defined by the **Uniform Partnership Act**

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3 Such as the limited partnership, the joint State corporation and the business trust.

1967[4] as "an association of two or more persons to carry on as co-owners of a business for profit."

The limited partnership, which permits a general partner (or partners), personally liable without limitation, to join in business with one or more limited partners, according to the **Uniform Limited Partnership Act 1967.**[5]

The joint stock corporation, which is formed by an agreement called a "Deed of Settlement" (also called "Articles of Association") which resembles Articles of Incorporation. This business form is basically a partnership, and lacks the separate entity of a corporation.

The business trust, which is referred to also as a Common Law Trust, or a Massachusetts Trust, and is a form of a common law trust adapted to commercial use. This form of trading originated around 1850 in Massachusetts, to overcome the restrictions upon corporate ownership of real estate. Although the 1912 Massachusetts Act[6] lifted that restriction, this form of business has continued to be used mainly by the public services and investment companies, but not by the private sector.[7]

The corporation or the limited corporation, which had until recently no limit on the maximum number of their shareholders, and did not distinguish between public and private corporations. The same legal structure served the giant Bell corporation and the street-corner grocery shop, and the same duties

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4 The Uniform Partnership Act, 7 ULA, (Supp.1967, p.9), has been adopted in 40 states and the District of Colombia, Guam and the Virgin Islands, but four of them (Delaware, Kentucky, Oregon and Wyoming) have not enacted the Uniform Limited Partnership Act, but they might have other legislation on this topic.

5 The Uniform Limited Partnership Act, 8 ULA (Supp. 1967, p.9), has been adopted by 42 States and the District of Colombia and the Virgin Islands but six of them (Florida, Georgia, Hawaii, Iowa, New Hampshire and Mississippi, have not enacted the Uniform Partnership Act).

6 Massachusetts Acts, p.600, Ch.595.

7 States which have specific legislation re the business trust are: Massachusetts, New York, Oklahoma and Wisconsin.

were imposed on both by the law.

The initial differences between the sizes of corporations were introduced by tax law, and not by commercial law. In each of the States there used to be only one corporation act, which applied generally to most business corporations, regardless of size. This state of affairs attracted many critics, and by 1969 there had developed a trend by which States were attempting to define and legislate for the small enterprise.[8] The introduction of the close corporation has ended the situation whereby all corporations, with any number of owners from one to infinity, were of identical legal standing, and the previous equality between the large and the small, and between private and public corporations, has been somewhat altered. Only "somewhat" and not completely, because in most States the status of a close corporation is not obligatory, and the corporation is allowed to elect whether it wishes to be considered as a close corporation or a general one.

(b) The Ownership Criterion in the Tax Laws

As mentioned, the tax laws have created two additional concepts of corporations besides the common one. These are the personal holding company and the elected small business corporation, which is also referred to as the "closely held corporation", "Sub-chapter S corporation", "pseudo-corporation" and "tax option corporation". The creation of the personal holding company was intended to supervise, regulate and tax the profit distribution of those corporations where ownership and control were closely linked. Its creation resulted in a heavy tax burden on the small corporation, and necessitated the introduction of the elected small business corporation to mitigate the disproportionate tax burden on the small business.

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8 William L.Cary, Cases and Materials on Corporations, University Casebook Series 15, fourth edition, Mincalo Foundation, 1969, p.2.

(b.1) The personal holding company

The concept of the "personal holding company", as distinct from the common corporation, was put before the Congress as early as 1928. In 1934 an amended version was suggested, and was later incorporated into Sec.542 of the 1954 **Internal Revenue Code.** The most significant part of the definition of a personal holding company is that it is a corporation with no more than five owners.[9]

Although an ownership by five individuals does not necessarily imply a small business, in practice the Accumulated Earning Tax, which was imposed on the personal holding company and not on the larger type of company, has been virtually confined to the private or to the closely held corporations. Only one public corporation, Trico Products Corporation,[10] has ever come within its web, and then because the main controlling interest was held by a few shareholders. To be classified as a personal holding company entails a restriction on accumulation of profits in the corporation, and an enforcement of their distribution to the owners, who have to pay personal taxation on the already taxed corporation income.

This situation, in which small businesses were penalised by disproportionate tax burdens, lasted until 1958, when the tax authorities accorded a corporation whose set-up permitted it to elect to be taxed as a partnership and not as a corporation, which amounted to its owners being taxed as individuals. This was supposed to give a measure of relief against penalty taxes, but it did not help the expansion of the small business,

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9 Sec.542(2) reads:
"Stock ownership requirement; At any time during the last half of the taxable year more than 50% in the value of its outstanding stock is owned directly or indirectly by or for not more than 5 individuals."

10 Trico Products Corp., 46 BTA 346 (1942), affirmed 137 F.2d 424 (2nd Cir. 1943), certiorari denied 320 US 799, 64 S.Ct. 369 88 L.Ed. 482 (1943).

since it was forced to distribute its profits rather than retain them in the corporation.

The introduction of the elected small business corporation has invalidated the personal holding company, because any of the latter could elect to be taxed as the former. This is so because the number of owners stipulated by the elected small business corporation was increased to 10 instead of the five of the personal holding company. Prior to the creation of the elected small business corporation, the owners of the personal holding company had the most limited options of tax planning in comparison with the owners of the other trading forms, because while the unincorporated businesses (sole ownership or partnership) could elect to be taxed as a corporation,[11] the income of the owners of the personal holding company continued to be taxable directly from the individuals and not from the corporation.[12]

The aforementioned privilege of an unincorporated business to elect to be taxed as an incorporated one was granted only if the enterprise satisfied certain conditions, the first of which was that it was not owned by more than 50 individual members.[13] Thus it seems that for the corporations whose number of owners did not exceed five individuals, its method of taxation was not a matter of choice, but a legal imposition, whereas for the unincorporated body with a maximum of 50 owners, the election to be taxed as a corporation was a matter of choice. This restriction has curtailed any tax planning by the corporation with the small number of owners, while permitting it to the larger organisation.

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11 Internal Revenue Code, Sec.1361, 26 USCA.

12 Ibid., Sec.1361(1).

13 Ibid., Sec.1361(b).

(b.2.) The elected small business corporation or the closely held corporation

The elected small business corporation, which is also referred to as the "closely held corporation", or "Sub-chapter S corporation",[14] is a unique creation of US legislation, in that it is a hybrid of a corporation and a partnership. It maintains the legal advantages of a corporation - limited liability, separate entity and continuity - but is taxed as a partnership. This type of corporation has been introduced by the tax authorities as a result of the strong criticism levelled against the discriminatory aspects of the personal holding company. Its purpose is to offer the owners of small businesses an option to be taxed either as a corporation or as individuals, because corporate income is usually subject to double taxation, once as an income to the corporation, and again as an income to the shareholders in the form of dividend distribution.[15]

To qualify as an elected small business corporation,[16] the latter has to have a single class of shares that are held by not more than 10 shareholders, and to meet other requirements including a unanimous decision by the shareholders to be taxed as individuals rather than as a corporation.[17] The issue of the 10-owners limitation was raised in **A & N Furniture**

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14 This type of company is referred to as a Sub-chapter S corporation because it was introduced in 1958 by Sub-chapter S of the Internal Revenue Code in Secs. 1371-1377. These sections were introduced by Sec.64(a) of the Technical Amendments Act 1958 as part of a package of reforms intended to aid small businesses.

15 Internal Revenue Code 1954, Sec.6(a).

16 For the purpose of this chapter, the term "small business corporation" means: a domestic corporation which is not a member of an affiliated group (as defined in Sec.1504) and which does not:
1. have more than 10 shareholders;
2. have as a shareholder a person (other than an estate) who is not an individual;
3. have a non-resident alien as a shareholder; or
4. have more than one class of stock (26 CFR, p.388, S.11371).

17 26 CFR, Secs.1371, 1372.

and Appliance Co. v. U.S.,[18] from which it transpired that the tax authorities saw in the creation of the elected small business corporation a concession granted only to small businesses. This indicates that although it is obvious that the limitation of the owners cannot always coincide with an actual small business, as far as the tax authorities were concerned, that was one of its definitional criteria.

In **Donahue v. Rodd Electrotype Co. of New England Inc.,**[19] the Court suggested that Sub-chapter S is a recognition by the Federal Government that close corporations, that is, corporations with a small number of owners, were merely incorporated partnerships and were to be taxed accordingly.

As to who constitutes a shareholder, the regulations have offered the following definition: "Ordinarily, the persons who would have to include in gross income dividends distributed with respect to the stock of the corporation are considered to be the shareholders of a corporation."[20] In situations where a husband and wife[21] own stock in the same corporation, they are counted as one shareholder if they hold the stock jointly, or if they hold some of the stock jointly and some of it individually. But if they own all their shares individually they count as two shareholders.[22]

(c) The Ownership Criterion in the Commercial Laws Governing Corporations

The law of corporation is only a segment of commercial law, which in contrast to the all-embracing Federal tax laws is peculiar to each State

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18 A & N Furniture and Appliance Co. v. US, 58 TC 985, 1972, 271F Supp.40.

19 Donahue v. Rodd Electrotype Co. of New England Inc., Massachusetts, 328 NE 2d 505, 1975.

20 26 CFR, Sec.1 1371-1(d)(1), p.390.

21 Ibid., Sec.1 1371-1(d)(2).

22 Ibid., Sec.1 1371-1(d)(2)(b).

in the USA. This in itself is bound to create a multitude of differences, if not as to the actual meaning attributed to business ownership, then definitely with regard to the numerical determinants that decide the rights and duties of the different types of ownerships. Hitherto only one type of different ownership which relates to a small business has surfaced: the close corporation.

The main problem with the US corporation laws is that the legislation does not distinguish between small, private, large or public corporations. In practice this means that the one-man or family corporation is regulated by the same laws as the multi-national giants, with tens of thousands of investors, thousands of employees, and hundreds of managerial personnel.

Although there is a consensus that close corporations have a small number of shareholders, their other characteristics and the actual number of their shareholders have been subject to various interpretations. For example, Farnsworth[23] has suggested that the term "close corporation"

> "...generally connotes a business association in the corporate form, with a small number of shareholders who actively participate in the management of the business, and whose shares are not publicly traded... The shareholders typically double as officers and directors, equating ownership with management and control."

O'Neal,[24] on the other hand, draws a distinction between the close corporation and the closely held corporation. He suggests that "close" implies shareholders intent on agreeing to keep outsiders from acquiring any interest in the corporation, whereas "closely held" implies a small number of shareholders. Chief Justice Tauro in **Donahue**[25] has employed different terms to refer to the close corporation, such as "closely held corporation", "one-man corporation", "family corporation", "incorporated partnershp"

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23 Alan H. Farnsworth, "Recent Developments", Cornell Law Review, Vol.61, 1975/76, p.986.

24 F.H. O'Neal, Close Corporations : Law and Practice, Callaghan, Chicago, 1971, Sec.1.02.

25 Supra, note 19, p. 434.

and "chartered partnership". In **Brooks v. Willcuts**[26] a close corporation was defined as "a corporation in which the stock is held in few hands, or by few families, and wherein it is not at all or only rarely dealt in by buying or selling." It seems that a unanimously agreed upon definition of a close corporation does not exist, yet one seems to know what is meant by it. This is reminiscent of Justice Stewart, who declined to define obscenity, and who stated only that he knew it when he saw it.[27]

The court in the **Donahue** case tried to identify the qualitative criteria typifying close corporations, and mentioned the following:

1. A small number of shareholders.
2. No ready market for the corporate stock.
3. Substantial majority of stockholders participating in the management, direction and operation of the corporation.

While these qualitative criteria have been used to varying degrees of emphasis in other definitions of close corporations, there is no agreement as to their numerical determinants, and although it is accepted that a close corporation is usually a small business, size alone is not a determinative factor. This argument is supported by such examples as the Ford Motor Corporation which was closely held until 1956. The reason for the association of the close corporation with a small number of shareholders is the affinity between its ownership and the management. It is this integration of ownership and management that gives it its quasi-partnership characteristics.

(c.1) The close corporation

The close corporation, as a legal concept different from the general term of corporation, was first introduced into US legislation in the State

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26 Brooks v. Willcuts, 78 F.2d 270, 273 (8th Cir. 1935).

27 Jacobellis v. Ohio, 378 US 184, 197, 1963; concurring opinion Justice Stewart.

of Delaware in 1953.[28] Subsequently, two different methods of close corporation legislation can be detected. The first has introduced the relevant legislation either as a completely separate Act, or as a separate division of its Act dealing with business corporations, designed to deal exclusively with the close corporation; and the second has employed an amendment of particular sections within the general corporation laws. Since 1953, when the State of Delaware introduced its amendments regarding the close corporation,[29] other States have followed in its steps, adopting one of these methods of legislation.

The discordant situation of US legislation as regards the meaning and definition of the close corporation can be ascertained from the study of relevant legislation in the following six States: Delaware, Florida, New York, California, Maryland and Texas.

(c.1)a. Delaware

In 1953 the **Delaware Code Annotated** permitted "close" status where there were no more than 30 shareholders, no public offerings of stock, and restrictions on transfer of all classes of stock.

The shareholders had the option to elect to be a "close" or a "general" corporation, but the Code required that the certificate of incorporation or amended articles of incorporation would include the statement that the entity was a "closed corporation". This was done in order to give notice to outsiders about the status of the corporation, and to ensure some degree of consent by shareholders to fundamental changes in management structure.

In 1967 Delaware overhauled its corporation law, and in 1974 it introduced Sub-chapter XIV titled "Close Corporations: Special Provisions".

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28 Delaware Code Annotated, Title 8, Sec.342 of 1953.

29 Ibid.

(c.1.)b. Florida

Florida originally[30] defined a close corporation simply as a corporation for profit whose shares are not generally traded in organised securities markets, but this definition was criticised as being incomplete and ambiguous, and was repealed in 1975.[31] Florida's general **Corporation Act** has been amended, and since January 1, 1976 there has been no statutory distinction between "close" and general corporations.

The case of Florida is an exceptional one, in that not only was it the first State to introduce legislation for close corporations, but was also the first to reverse the trend of segregating small corporations from large ones, and return to the former legislation of a general corporation.

The fact that Florida has repealed its recognition of the close corporation should not be seen as an ominous sign of the trend to come. The vague wording of that definition, and especially the lack of any quantitative determinants, must have contributed to the decision to abandon the separate treatment of small companies. The Florida attempt to introduce a purely qualitative definition into legislation has failed, and has proven that in practice the lack of quantitative determinants, arbitrary as they are claimed to be, produces unworkable legislation which is tantamount to no legislation at all.

(c.1)c. New York

The need to reform the corporation laws and provide for the characteristics of close corporations was felt in the State of New York as early as 1957, when the first Joint Legislative Committee to Study the

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30 Florida Statute Annotated, Secs. 608.70-77, West, 1963, repealed 1975. This statute was generally viewed as having been poorly drafted and was repealed effectively from Jan. 1, 1976 by Florida Laws Ch.75-250.

31 Ibid.

Revision of Corporation Laws submitted its interim report to the 1957 session of the New York State Legislature.[32] By 1961, after five years of extensive law revision effort, and the expenditure of more than one-third of a million dollars, the State of New York had introduced the **New York Business Corporation Law 1961.** It is interesting that in such a complete revision, New York has chosen a unified corporation statute applicable to public and close corporations alike. The decision was apparently taken because of the New York Law Revision Commission's inability to arrive at a precise definition of the close corporation.

There are, however, certain provisions in the New York law which, though not textually addressed to the close corporations, are mostly utilised by them, and perhaps drafted with them in mind. One of these allows the certificate of incorporation to provide for greater than the normal quorum requirements; and another permits a corporation with fewer than three shareholders to have fewer than the statutory number of directors.[33] On the whole its concessions to small businesses are negligible, consisting chiefly of the previously mentioned ones. The reduction in the number of directors has cleared up the de facto situation which existed till then, whereby corporations with a small number of shareholders used "straw directors" without any real functions, in order to comply with the legal requirements.

(c.1)d. California

In 1976 California introduced the **New California Corporation Code** with effect from January 1, 1977.[34] It defined a close corporation

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32 New York Legislative Document No.17, at 115-20, discussed by Hoffman, "New Horizons for the Close Corporation in New York under its New Business Corporation Law", 28 Brooklyn Law Review, 1, 2 (1961).

33 New York Business Corporation Law, Secs.616,702 (McKinney 1963 and Supp.1975)

34 New California Corporation Code, 158 West, 1977.

as one that did not have more than 10 shareholders. This ceiling paralleled the shareholder limitation of Sub-chapter S,[35] according to which the shareholders could be only individuals or estates, while the California statute clearly indicated that a trust, a partnership, a corporation or a business association could be shareholders in a close corporation,[36] and count as one shareholder, unless it was specially formed to evade the numerical limit. A husband-and-wife ownership counted as one shareholder regardless of how the shares were held, by either or both spouses. The decision to consider the number of 10 shareholders as the determinant for a close corporation status was reached after a suggestion to fix this number at 35 was voted out.

California, like Delaware, has permitted shareholders to elect whether they want to be considered as a close or a general corporation. This raises the problem of whether a small enterprise that does not elect to become a close corporation is automatically subject to all the provisions applicable to publicly held corporations, or whether such a "closely held", but not in the statutory sense "close", corporation can still avail itself of some of the judicially recognised devices for small corporations.[37]

The California legislation has rejected the idea of completely separate legislative treatment of close corporations, either in a new and distinct statute or in a separate chapter of the corporation code. Thus the California corporation provisions are scattered through the statutes.

(c.1)e. Maryland

The **Maryland Corporation and Associations Code**

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35 Secs.1371-1379.

36 Technical Amendments Bill, Sec.158(a).

37 Don Berger, "California New General Corporation Law; Close and Closely-Held Corporations", Pacific Law Journal, Vol.7, p.587, 1976.

Annotated[38] has adopted a novel approach to the definitional problem. It allows any corporation that becomes subject to the act to decide whether it wants to be treated as a close or a general corporation, without any legal specification of what constitutes a close corporation. The only restriction on such election was the requirement that the certificate of incorporation or amended articles of incorporation include a statement that the entity is a close corporation, and that such a decision is reached unanimously by all the shareholders.

The unanimity requirement effectively renders the selection of a close corporation status virtually impossible for a publicly held corporation. This seems to accomplish the purpose of a definition being the segregation of one defined from another, and at the same time avoids the difficulties inherent in most definitional attempts, because no definition as such has been formulated. It could be said that the Maryland definition is a definition by default.

In keeping with that approach, the statute does not prohibit the stock of such a close corporation from being traded publicly. Likewise it does not impose limitations on the size of the shareholder groups or the assets of the corporation.

(c.1)f. Texas

The **Texas Business Corporation Act Annotated**[39] has defined a close corporation in accordance with three criteria:

1. No more than 15 shareholders.
2. Restrictions on transfer of shares.
3. No public offering of shares.

The Texas law does not allow the corporation to elect its status,

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38 The Maryland Corporation and Associations Code Annotated, 1975, Secs.54-101(b); 4-21.

39 The Texas Business Corporation Act Annotated, 1975, Article 2.30 1A, Supplement 1975.

and the fulfilment of these three criteria brings automatic "close corporation" status. Because of this automatic application of the law, it is not required from the close corporation to state in its articles that the company is a close one, unless radical changes in management are contemplated.[40]

(c.1)g. Summation

The present legislation in respect of the close corporation in the different States of the USA can be divided into four groups:

1. States that do not differentiate between a close and a general corporation.[41]
2. States that define a close corporation only qualitatively, without any numerical determinants.[42]
3. States that rely solely on numerical definitions.[43]
4 States that use a numbers test but also include additional limitations, such as denying the corporation a public stock issue, or requiring some restriction on the transfer of

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40 Ibid., Article 2-30 - 1B.

41 States that do not differentiate between close and general corporations; (e.g.) Massachusetts, Florida's Corporation Act 1976, Illinois, Tennesee Code Annotated 1975.

42 States that offer or offered a qualitative definition of close corporations without any numerical demands: (e.g.) Florida Statute Annotated Sec.608.70(2) Supplement 1975, repealed by Florida Statute Annotated Sec.607.001-A11 Supp.1975; Maryland Annotated Code, Art.23, Sec.100(a) 1973.

43 The laws that rely solely on number of shareholders are:
a) Puerto Rico Laws Code Annotated Title 14, Sec.1102(c) 1971: 11 shareholders.
b) Rhode Island General Laws Annotated Sec.7-1.1.51(d) 1969: 30 shareholders.
c) Wyoming Statute Annotated Sec.17-36.32(c)(d) 1965: 20 shareholders.
d) New California Corporation Code 158 West 1977: 10 shareholders.

shares.[44]

From this division it is evident that there exists great confusion as to what constitutes a close corporation in the USA. It might be claimed that this discord is built into the legal system of the USA on account of the legislative independence of each State, and therefore that the degree of difference regarding the definition of a close corporation is not out of line with that of other legislations, and as such it ought to be accepted as "part of the system"; but it would be answered that the law of commerce which includes definitions of close corporations is unlike most other fields of the law, because commerce by its nature is usually not restricted by geographical boundaries. Hence a uniform definition of such an inter-State institution is more essential than, for example, that of a medical institution, for which the lack of a uniform definition would not be particularly detrimental.

(ii) The Ownership Criterion in the Legislation of the People's Republic of China

The subject of ownership in the People's Republic of China ought to be viewed in the context of the country's political and economic system. In a professed communist regime one cannot expect to find similar ownership patterns to those practised in the capitalist economies.

There are three types of ownerships in the People's Republic of

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44 The laws that rely mainly on the number of shareholders, plus other qualifications, are:
a) Delaware Code Annotated Title 8 Sec.342 1974: 30 shareholders, no public offer by corporation, restriction on transfer.
b) Kansas Statute Annotated Sec.17-7202 (Supplement 1972): same conditions as Delaware.
c) Pennsylvania Statute Annotated Secs.1371-1386 (Supplement 1977): 15 shareholders, otherwise similar to Delaware.
d) Texas Business Corporation Act Annotated Article 2.30-1(a) (Supplement 1975): 15 shareholders, otherwise similar to Delaware.

China,[45] two of which,

State ownership[46] and collective ownership by the whole people, receive the government's official support, and the third, sole ownership of the urban self-employed and rural peasants, is tolerated but not promoted.[47]

Ownership by the whole people is by far the largest,[48] as it includes all the natural resources of the country, the means of communication and the heavy industries, such as steel, coal and ship-building. It is therefore obvious that this type of ownership does not host small businesses. And as it is intended to deal primarily with the type of ownerships which accommodate and cater for small businesses, it would be pointless to elaborate on state ownership in the present context.

(a) Sole Ownership

The term "sole ownership" as used in China is more similar to that of "self employment" in the USA, the UK and Israel than these countries' use of "single owner" to mean one owner who controls large assets or production units. It is only the "self-employment" type of sole ownership that is allowed and exists in the People's Republic of China, and even this is subject to restrictions on size and area of operation.[49]

The sole ownership of enterprises is of two types: one which the owner engages in exclusively and which is his sole source of income; and

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45 The Constitution of the People's Republic of China 1978, adopted by the Fifth National People's Congress at its First Session on Mar. 5, 1978, Article 5. The 1954 Constitution prescribed a fourth form of ownership, the capitalist one, and the 1949 First Constitution of Peking, known as the Common Program, divided the "new democratic" economy into five sectors: state, co-operative, individual, state capitalist, and capitalist, but mentioned nothing concrete about ownership.

46 The Constitution of the People's Republic of China 1978, Article 5.

47 Ibid.

48 Ibid., Article 6.

49 Ibid., Article 5.

the other which is carried out as a sideline to a fulltime occupation. The former is to be found mainly in the urban areas, and the latter in the rural ones; and both are managed on a very small scale. The urban type of ownership is dealt with by Article 5 of the **1978 Constitution**, and the rural one by Article 6.

Although the Constitution allows a slight concession to ownership of the means of production, it is not a right that has always been respected or upheld. Under the "Gang of Four" private ownership, even in its limited form of self-employment, was scorned, harassed and in most cases prohibited.

The issue of sole ownership is linked to the control of the means of production. Out of the three economic ownerships available to the individual - land, capital and means of production - the first has been obliterated, the second has been deactivated (except for personal savings), and the third, though existing in minute quantities, is in direct conflict with communist doctrine which accords the control of the means of production to the State and the working masses, not to the individual. If this is rigidly interpreted, then "means of production" are all the "means of production" regardless of size or quantity, and would also include a tailor with one sewing-machine or a carpenter with one lathe. At times, especially after 1957, it seemed that this interpretation was the prevailing one. This attitude is demonstrated by the following verbatim transcript of the description of the Chinese legal system by members of the law faculty of Peking University in 1975,[50] prior to the recent political changes that took place there:

> "Our law is to protect the socialist property. First, our law is to protect the State property. Next it is to protect the collective property (i.e. of the communes and factories). Civil law in China also protects the legal rights of the Chinese citizen - to protect

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50 Richard P. Brown, Jr., "Present-Day Law in the People's Republic of China", American Bar Association Journal, Apr. 1975, Vol.61, p.475.

the "means of consumption", not the "means of production". Since 1956 we have carried out this socialist transformation of the private ownership of the means of production. There is no longer any problem of private ownership of the means of production. Under the Communist system as followed in China, there is no private ownership of "means of production", such as a factory or a farm. There can be private ownership of "means of consumption", such as money saved, furniture, bicycles, radios and other consumer goods."

(b) Urban Small Businesses

Today such a description is incorrect, for it seems that the principles of the **1978 Constitution** are being upheld and self employment and co-operative ownerships are allowed. In the urban centres small businesses run on sole ownership lines are flourishing, as is verified by a recent publication of June 17, 1980.[51]

In Beijing the municipal government has announced that retired skilled workers and unemployed young people are permitted to open service and trade businesses. The procedure involved is that in order to be registered as a trader or self-employed, a person must register at the local industry and commerce bureau, produce a letter of recommendation from the local neighbourhood committee and pass a test of technical competence before getting a permit. Once they get the permit they can operate their skill or shop, with the assistance of their family, but they are not allowed to employ others. They are also restricted to a limited choice of their field of occupation; this must be a service that supplements those run by the State. Within these constraints, individuals are urged to develop the privately owned sector of the economy. Once they operate, they are expected to pay Business and Profit Taxes, which presently in Beijing's eastern city districts run on a sliding scale from 7 to 70%, depending on net profit.[52]

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51 "Beijing to Revive Individual Service Trade Business", Xinhua News Agency, June 17, 1980, news item 061617, p.3.

52 Ibid.

Despite these restrictions and high taxes, the relaxation of the prohibition of sole ownership has been accepted enthusiastically. The fact that nearly 100,000 such small businesses had opened throughout China by the end of 1979 speaks for itself.[53] Yet though the number of 100,000 is impressive, their business turnover is less than 1% of that of the State and the collectively owned enterprises together; but again 1% of the total turnover of the People's Republic of China is an impressive figure in itself.

Yet notwithstanding this upsurge of small commercial ownerships, their place in the Chinese economy is not secure, as the same Article 5 that breathed life into the individual ownerships has also given them the last rites. After declaring that the State permits the engagement in individual labour involving no exploitation of others, the Article ends as follows: "At the same time, it guides these individual labourers step by step onto the road of socialist collectivization", which in other words means that for the time being sole traders and small businesses are tolerated, but not for long; and the eventual and ideal aim is to ban them. The legal situation regarding the urban "sole ownership" seems to be as follows:

1. They are allowed.
2. The number of their owners is restricted to family members.
3. They need a permit, which requires:
   a) the approval of the owner's character by the local community;
   b) the approval of the field of trading by the local authorities.
4. They have to register at the local industry and commerce bureau.
5. They are not allowed to employ others.
6. They are subject to business and profit taxes.

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53 Ibid.

(c) The Rural Small Business

In the rural areas there are no small farms. By now they have all been organised into co-operatives and communes. The only types of sole ownerships that exist there are the "sideline" occupations of the co-operative members, and to a lesser extent of the commune members. These are allowed to be undertaken only in the spare time of the members, after they have discharged their standing obligations to their co-operative or commune.

This type of sole ownership is regulated by the second Section of Article 7 which states that:

> "Provided that the absolute predominance of the collective economy of the people's commune is ensured, commune members may farm small plots of land for personal needs, engage in limited household sideline production, and in pastoral areas they may also keep a limited number of livestock for personal needs."

Depending on the political climate, it is also possible for the members to sell their produce in the peasant or urban markets, and keep the profits for themselves. The rural sole ownership consists mainly of the cultivations of small plots of land and the sale of its produce, and/or that of handicrafts.

The legal situation regarding the sole ownership in the rural areas is that they are permissible on condition that:

1. Their owner's duty to the commune is discharged first.
2. The size of the tilled land is small.[54]

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54 The size of the private plot retained by each household is determined according to the number of persons in each household and the total amount of land in that particular area. The maximum allowed per person cannot exceed 5% of the average individual land-holding of the commune (Article 17 of the Model Regulations for an Agricultural Producers' Co-operative, adopted by the standing committee of the National People's Congress of the People's Republic of China on Mar. 17, 1956 at its 33rd session). The 5% rule was used also by Article 16 of the Model Regulations for Advanced Agricultural Producers' Co-operatives (adopted on June 30, 1956 by the First National People's Congress at its third session).

3. If the occupation is a household sideline, it is limited in output.[55]

4. It is for personal needs.

Article 7 has tried to ensure that such sideline occupations are for personal and not for commercial needs. The interpretation of "limited" and "personal needs" depends on the authorities' requirements. When they believe that the sidelines are needed to augment the variety of products on the market, the requirements are interpreted widely, allowing a lucrative trade for the peasants; but when it is believed that it contradicts socialist principles, they are interpreted strictly to forbid any private trade.

At present, it appears that peasants' markets flourish[56] because the political climate has allowed a lax interpretation of Section 7. Initially the official prohibition was overcome by a barter system which was carried out at the peasant markets, but with the relaxation of the controls, the barter system was replaced by the actual transfer of money from buyer to seller. The only controls that exist at the moment are those of price, which are there to guarantee that the sideline occupation of the peasants does not become so lucrative so as to jeopardise their obligations to the commune.

(d) Co-operatives

There are two forms of joint ownerships in China, co-operatives and communes. The communes operate as extremely large units[57] and therefore cannot be considered a suitable legal form for small businesses. Their large size has raised the question of whether or not commune

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55 By household sidelines are meant handicraft occupations by the family such as knitting, embroidery, and basket-weaving.

56 See p. 134.

57 The Resolutions of the Central Committee of the Chinese Communist Party on the Establishment of People's Communes in the Rural Areas, Aug. 29, 1958, Sec.2, fixed the size of a commune between 2000 - 20,000 households. Fundamental Legal Documents of Communist China, Albert P. Blaustein (ed.), Fred B. Rothman & Co., South Hackensack, New Jersey, 1962, p.444.

ownership is a form of State ownership.[58] In a resolution of December 1958, the Party decided that commune ownership, although having elements of State ownership, would remain a form of collective ownership pending its transition to State ownership.[59] In 1959 this was resolved by the adoption of a new form of collective ownership for the communes, based on a three-level structure: the commune, the production brigade and the production team.[60] Initially the communes were purely for agricultural production, but have since expanded into all aspects of production.[61] Today most agricultural production is organised in commune form, while the co-operative form is the only legal one for urban small businesses. It has been defined as follows:

> "A producers' co-operative is a collective economic organisation formed on a voluntary and mutually beneficial basis by working peasants with the guidance and help of the Communist Party and the People's Government. In such a co-operative the principal means of production owned privately by members are put under a single, centralised management and gradually turned into their common property; members are organised for collective work and the fruits of their labour are distributed according to a common plan."[62]

Since the abolition of the partnership and corporation laws that existed in pre-Communist China,[63] the co-operative has been is the only

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58 Gene T. Hsiao, "The Role of Economic Contracts in Communist China", California Law Review, Vol.53, 1965, p.1038.

59 Central Committee of the Communist Party of China, Resolution adopted Dec. 10, 1958.

60 Central Committee of the Communist Party of China, Resolution of Feb.16, 1959.

61 The two most acclaimed communes in China are Tachai in agriculture and Taching in industry. Taching has specialised in oil production.

62 The Model Regulations for an Agricultural Producers' Co-operative, 1956, Article 11.

63 In pre-Communist China, partnerships were regulated according to two laws. The Civil Code dealt with the traditional form of partnership, the ho houo, which was similar to the English partnership; and a special law handled the commercial partnership, which was called kong sseu and of which there were several permutations, including the simple limited partnership and the limited partnership, which was used by the commercial world in a similar way to the limited company in Britain. F. Thery SJ, On Commercial Partnerships in China, Tientsin, 1929.

legal form in which individuals may engage in commercial activities. The co-operative has the characteristics acquired with incorporation, such as separate legal entity from that of its members, and continuity. It has to be registered with the rural council, or the municipality or suburban district authorities.[64] This entails the filing of the co-operative's regulations, the names of its ordinary members and of those elected to its management bodies.

(d.1) Membership

Membership in a co-operative is restricted by age to 16,[65] but is not limited in number, either at the lower or the upper end, which means that even two persons can incorporate themselves into a co-operative.[66] This is of importance particularly for urban co-operatives, which in many instances are equivalent to the former institution of a partnership.

Members of a co-operative, unlike those of a commune, are owners, because on their withdrawal from the co-operative they are allowed to take with them, in addition to their private belongings, their share of contribution and investment. In cases where the investment is immovable or is required by the co-operative, the withdrawing member receives its equivalent value;[67] but commune members can withdraw only with their personal belongings.[68]

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64 The Model Regulations for an Agricultural Producers' Co-operative, 1956, Article 11.

65 Ibid.

66 In Israel a co-operative has to have at least seven members before it can be registered as one. In Britain the registration of a co-operative with fewer than 20 members is voluntary, but if it had over 20 members registration would be technically unlawful under the Companies Acts. In the USA the agricultural co-operative was defined in Sec.15(a) of the Agricultural Marketing Act 1929 (12 USC 1141 j), with no limitations as to the number of its members.

67 Article 15, supra. note 57, p. 449.

68 In the UK, industrial communes are dealt with by the Industrial Common Ownership Act 1976, whose Sec.2(1)(b)(ii) disallows the distribution of a Common Ownership Asset to its members on its winding up.

(d.2) Share Capital

Co-operative members have only one vote irrespective of the size of their investment in the co-operative. The investment can be in kind and/or in money. The former would take the form of trade implements or machinery, and the latter of money derived from savings.[69] Members lacking capital to invest can equate it to labour and can "buy themselves in" by instalments.[70]

(d.3) Employment

Co-operative members are allowed to employ non-members, preferably on a non-permanent basis,[71] for seasonal or expert tasks. Those so hired are expected "to be treated properly", which must mean principally "not underpaid". In fact, at times of labour shortage, it has been known for co-operatives to pay higher wages than State-owned enterprises.[72]

The co-operative pays its members according to their work input,[73] which during the rule of the "Gang of Four" was in contradiction to communist teaching of "payment according to needs". At the end of the year, if the state of the enterprise allows it, bonuses[74] are distributed

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69 Savings, and their deposit in banks for a return, have been encouraged in China. This money cannot be invested as capital without labour, but it can be invested in a co-operative enterprise, accompanied by its owner as a member. In a news item "Bank Deposits Increase by Big Margin", (news item 071031, Xinhua News Agency, July 10, 1980), it is reported that China's rural and urban deposits in banks rose by a record figure. This was explained by the increase in bonuses for workers and more employment. Other reasons were the higher income for peasants, so that they were not dependent on working relatives, and a rise from 20% to 36% in interest rates. As the ownership of personal money or, as referred to, "ownership of consumption", in contrast to "ownership of production" has always been upheld in China, the personal savings of the population can be channelled into co-operative enterprises.

70 The Model Regulations for an Agricultural Producers' Co-operative, Ch.3.

71 Ibid., Article 5.

72 Christopher Howe, Wage Patterns and Wage Policy in Modern China, 1919-1972, Cambridge University Press, 1973, p.102.

73 Supra, note 71.

74 Article 7, supra, note 70.

to members and workers alike.

(e) Summation

The People's Republic of China provides the proof that "small" equals "private", because there "big" can only mean "State" or "communally owned". This shows that the argument that can be put forward in capitalist economies - that "private" is not synonymous with "small" because it is also sometimes "big" - does not hold good in the People's Republic of China, where the only forms of ownership that permit the private element to any extent are invariably ones that are suitable only for the operation of small businesses. Since there is so little choice of ownership forms, it is not a question of how each of them has catered for small businesses, but of which ownership forms small businesses have been allowed to use. Thus it is not the quantification of ownership that is discussed, but its existence.

There are only two forms of ownerships open to small/private businesses in the People's Republic of China, sole ownership and the co-operative. And as the former is restricted to family members, because of the prohibition on employing ("exploiting") others, its scope of activities is minimal, which leaves only the co-operative as a business form that allows a small enterprise to develop into a semblance of a "business", rather than a family-owned and worked unit.

The Chinese co-operative has managed to overcome the four fundamental constraints which have been imposed on private enterprises by communist doctrine, namely:

The inability to own means of production.

The inability to employ labour.

The inability to use capital.

The inability to draw profits.

The first inability is overcome in three ways:

(a) By investing the ownership title in the legal entity of the co-operative instead of in the individual owner.

(b) By replacing the title of co-ownership with that of membership. This is achieved by replacing the power of capital ownership, that is, of shareholding, by an equal voting power of the members, regardless of the size of their capital investment in the co-operative.

(c) By stipulating that the members are also the workers and as such they are allowed to own the means of production.

The second inability is surmounted by using the labour of the members themselves, and employing only technical, specialised or seasonal labour, which is tolerated, even if not considered "correct". In periods of high unemployment, this is even encouraged.

The third inability is resolved by investing the capital in the co-operative and using it as working capital to generate business profits in the form of bonuses which yielded more than if deposited in banks.[75]

The fourth inability is dealt with by sharing the resultant residue of income over cost, among all the owners/members/workers, and calling it a bonus, which is related directly to labour - unlike a dividend, which is related to capital.

It seems that while in the USA the small business is seen as the amalgamation of ownership and management into one entity "individually owned and managed", in the People's Republic of China it is portrayed as the combination of three functions: ownership, membership and labour, multiplied by a number of individuals exceeding one.

Therefore a Chinese small business definition based on co-operative ownership would be:

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75 The Worker's Daily July 12, 1980, has a report of workers buying shares in the Harbin North China Company, a furniture producer. The shares were sold in $60 lots and were expected to yield at least as much as bank deposits, but most probably more.

A small business is an association of persons each of whom combines the functions of owner, member and worker.

(iii) The Ownership Criterion in the Legislation of the UK

The quantitative facet of ownership as a criterion for describing a small business has been used in three groups of legislation: **The Partnership Act, The Companies Acts** and **The Finance Acts.** The first two are commercial laws, concerned only with the establishment of commercial forms of trading, while the third is a tax law intended to collect revenue. It would therefore seem logical that their interests and aims should not coincide. None of these legislations has used the actual words "small business", "small partnership" or "small company"; instead, words such as "private", "close" and "family" are employed in order to distinguish them from large concerns.

Sole ownership as practised in the UK does not contradict any of the country's ownership philosophies. On the contrary, it is deeply embedded in the legal system of the country. The sole owner is not allotted specific legislation, except in the requirements of the **Registration of Business Names Act 1916**, whereby he has to register his trading name if it is different from his own, and the usual trading requirements of licences. Because this type of ownership consists of the static number of one, it does not attract the complications that ensue from joint ownerships, and thus it is intended not to deal with it further.

(a) Partnership

Partnership was defined[76] as "the relation existing between two or more persons carrying on business in common, with a view of profit." An alternative definition would be:

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76 The Partnership Act 1890, Sec.1; The Limited Partnership Act 1907 introduced the limited partnership, which is not often used.

"Partnership" means the sharing of ownership in a business enterprise.

The term partnership can be replaced by that of joint or common ownership, and partners by co-owners.

The minimum number of owners in a UK partnership engaged in free commerce is two,[77] and the maximum is 20,[78] but certain professional partnerships are exempted from these restrictive ceilings.[79] Owing to the numerical restrictions on the number of owners of the UK partnership, it is viewed as an operational form suited only to small businesses. The usual restriction is that of the 20 owners imposed by the **Companies Act 1948**, but other legislations which have used the term partnership have allotted it their own numerical ceiling of owners.

Section 11 of the **Sex Discrimination Act 1975** has exempted a partnership with a maximum of five partners/owners from the equal acceptance and remuneration of female partners/owners. The figure of five is also used in the Act in Section 6(3)(b), for according a complete exemption from its jurisdiction to employers with a maximum of five

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77 Ibid.

78 The Companies Act 1948, Sec.434(1), restricted the number of partners to 20 persons, and in a banking business to 10.

79 The Companies Act 1967, Part IV, Sec.120, has abolished the numerical ceilings of partners imposed by the 1948 Act, in professional partnerships such as those of solicitors and accountants or stock exchange members. It has also elevated the ceiling of banking partnerships from 10 to 20.

The Partnerships (unrestricted size) Regulations No.1 1968 (SI 1968 No.1222); No.2 1970 (SI 1970 No.835); No.3 19700 (S.I.1970 No.835); No.3 1970 (SI 1970 No.992); and No.4 1970 (SI 1970 No.1319); have lifted the numerical restrictions from firms of registered patent agents, surveyors, auctioneers, valuers, estate agents, land agents and estate managers, if at least three-quarters of their members belong to their respective professional associations; and chartered engineers, if the majority of partners belonged to their professional association; and partnerships of building designers if not less than three-quarters of the members were registered architects.

employees. In connection with a partnership, this figure relates to the number of partners/owners; while in the context of employment, it refers to the number of employees without relation to the number of owners that constituted the employer. This means that the Act regulates not only relationships between employers and employees, but also between partners and potential partners, which amounts to regulating the relationship between owners and prospective owners. Not that this is contradictory to the Act's aims, but as the two relevant Sections 6 and 11 are found in Part II of the Act, which is headed "Discrimination in the Field of Employment", it is tempting to suggest that the Act did not consider partners as co-owners, but as co-employees. However, had this been so it would not have been in keeping with the Act's interpretation of employment as "employment under contract of service, or of apprenticeship or a contract personally to execute any work or labour",[80] and hence the suggestion that partnership is tantamount to employment is unacceptable.

The result of there being a numerical ceiling on the number of owners as well as the number of employees is that, in comparison with a sole trader or a company, a partnership is discriminated against by the extra obligation that the Act imposes on it. While a sole trader who employs only five employees, or a company with six shareholders and five employees are outside the Act's jurisdiction as a result of the general exemption of Section 6(3)(b), a partnership with six partners/owners and only one employee, let alone five, is within the Act's jurisdiction on account of Section 11.

A legislation with another interpretation of a partnership is Section 152 of the **Income and Corporation Taxes Act 1970**, where

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80 The Sex Discrimination Act 1975, Sec.82(1).

for the calculation of Income Tax, a partnership is deemed to be a trade or profession carried out by two or more persons jointly. Here the Act has dispensed with the upper threshold determinants, and satisfied itself with the lowest logical figure of two, below which a partnership cannot exist. By disregarding the upper threshold specified by the **Companies Act 1948**, and its ensuing Regulations,[81] the Act has liberated itself from the constrictions of the different ceilings imposed on the various trades and professions, which if abided by would have entailed numerous and complicated tax instructions.

If a straight answer were required as to the maximum number of partners in a UK partnership, it would be impossible, as according to:
the **Partnership Act of 1890**, it is unrestricted;
the **Companies Act 1948**, it is 20 persons and in banking enterprises 10 persons;
the **Companies Act 1967**, it is unrestricted for certain professions and in banking enterprises it is 20;
the **Partnerships (Unrestricted Size) Regulations of 1968 and 1970**, it is unrestricted for an additional list of professions;
the **Sex Discrimination Act 1975**, it is 5; and according to
the **Income and Corporation Taxes Act 1970**, it is unrestricted.

(b) The Private Company

Prior to the recent introduction of the **Companies Act 1980**[82] the structure of the private company was determined by the **Companies Act 1948**, which limited the number of its shareholders to 50, prevented the free transfer of its shares and prohibited their offer for

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81 Supra, note 79, p.456.

82 May 1, 1980.

sale to the public.[83] Although it was never spelled out that the private company was synonymous with a small company, it was accepted as such, chiefly on the premise that as the unrestricted number of shareholders of the public companies represented large companies, so the restricted number of shareholders of the private company ought to represent small companies. That this does not mirror reality has been proven time and again by the existence of large private companies.

The restriction of 50 shareholders imposed by the **Companies Act 1948** on the number of members of the private company was not an absolute restriction, because if the additional shareholders were employees or ex-employees[84] the 50 shareholder restriction could be removed and the numbers of shareholders increased indefinitely. Professor Schmitthoff has explained that the purpose of this enactment was to enable the private company to issue shares to their employees under "co-ownership" or similar schemes,[85] but because shareholding means co-ownership, the end result of this is that a company that has 200 shareholders out of which 150 were either employees or ex-employees would not have lost its status of a private company.

(c) The Close Company

The terminology of a "close company" has been introduced into the UK legislation by the **Finance Act 1922**, solely for the purpose of collecting corporation tax. It is defined as a company which is under the control of five or fewer participants or of participants who are directors.[86] Until 1937, the restrictions of the close company as regards directors' remuneration and benefits were so strict that for tax purposes

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83 The Companies Act 1948, Sec.28(1)(b).

84 Ibid.

85 C.M. Schmitthoff (ed.), Palmer's Company Law, 22nd edition, Vol.1, p.41, 4-07.

86 The Income and Corporation Taxes Act 1970, Sec.282(1).

the close company was deemed to be a partnership. The **Finance Act 1965**, as amended in Schedule 18, and the **Income and Corporation Tax Act 1970**, have somewhat relaxed the previous restrictions, so as to restore to the close company some of the characteristics of a corporation.

The decisive test of whether a company is a "close" one does not rely on the exclusive criterion of ownership, but on a combination of ownership and control, or control by itself. Furthermore, the "participant" of the definition does not have to be a present shareholder or owner of the company, but could also be a future one, "who is entitled to acquire share capital",[87] or who is "entitled to acquire a right to receive or participate in the distribution of the company".[88] In effect, the definition of Section 282 should read as follows:

> **A close company is one which is under the control of five or fewer present or potential participants.**

If the participants just control the company, then a maximum of five of them will constitute a close company, but if the participants are not just in control of the company but are its actual directors, then such a company will be defined as a close company even if the number of its participating directors exceeds five. In fact, there is no limitation to such a number, since the Act has not specified a numerical ceiling for participants who are also directors. The element of control is independent of ownership, because in order to acquire control it is sufficient to have "voting power"[89] without "share capital", and voting power is not tantamount to ownership.

The directors[90] of the close company are the de facto controllers

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87 Ibid., Sec.303(1a).

88 Ibid., Sec.303(1c).

89 Ibid., Sec.303(2a).

90 Ibid., Sec.303(5).

of the company's affairs. They are paid for their directorship, and control with their associates over 20% or more of the ordinary share capital of the company.[91] The director of the close company is not a replica of the director of a company as defined by the **Companies Act 1948** as a person who is not the company's employee,[92] nor its servant nor a member of its personnel,[93] though he can hold a salaried employment or an office[94] in the company, in addition to his directorship, and in that employment or office he is its employee or servant.[95] The director of a close company is its paid manager, who alone or with other associates owns or controls 20% of the ordinary share capital of the company.[96] In the close company, in contrast to the ordinary company, the demarcation line between ownership and control is diffused. If the duties of the close company are to be avoided, it is necessary to show the separation of ownership from control and the segregation of directorship from participation, but this is just what the family company cannot do, because its whole essence is the unity of ownership and control.

In conclusion it can be said that because the criterion used for the definition of a close company is not the exclusive one of ownership, but a

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91 Ibid.

92 Normandy v. Ind Coope & Co. (1908), 1 Ch. 84; Hampson v. Price's Patent Candle Co. (1876), 45 LJ Ch.437; Kerr v. Walker (1933), SC 458.

93 Hutton v. West Cork Ry. (1883), 23 Ch.D 654;
Moriarty v. Regent's Garage and Engineering Co. (1921), 2KB 766;
Burland v. Earle (1902) AC 83. The director is the company's "servant" as regards the company's responsibilities in case of his negligence in executing the company's business.
Scobie v. Steele & Wilson Ltd. (1962) SLT (Notes) 45.

94 The Companies Act 1948, Sec.54(1)(b).

95 Cyclists' Touring Club v. Hopkinson (1910), 1 Ch.179; Hutton v. West Cork Ry. (1883) 23 Ch.D 654; Stroud v. Royal Aquarium and Summer and Winter Garden Society (1903), WN 146; 19 TLR 656; Re: Lee Behrens & Co. (1932), 2 Ch.46; Anderson v. James Sutherland (Peterhead) Ltd. (1941), SC 203.

96 The Income and Corporation Tax Act 1970, Sec.303(5).

mixture of ownership and control with a greater emphasis on control, the close company it defines is liable to consist of more than the five participants specified by the law. This means that the figure of five participants is more of a guide-line than an imperative legislation, and as such it leaves the definition vague and manoeuvrable by the tax authorities who use it to further their own ends. But then this is most probably what the legislator set out to achieve in the first place.

(d) Summation

The fact that UK legislation considers the number of owners to be a major factor in the composition of an enterprise is evident from the division of businesses into those with x number of owners that have to incorporate, and those with y number of owners that are not expected to do so, and are permitted to perpetuate their chosen mode of existence. Incorporation is a major undertaking for an enterprise, as it alters its management, finance and legal structures. It stresses the importance of this criterion that the duty to incorporate hinges only on the enterprise's number of owners.

The thinking that links the number of owners with the duty to incorporate, has been based on the assertion that an increase in the number of owners is responsible for an increased complexity of relationships among the owners themselves, and between them and the public. In particular it is the public whom the legislation is meant to protect by enforcing incorporation on large co-ownerships.

The Companies Act 1948[97] chose the number of 20 co-owners as the cut-off figure to differentiate between incorporated multi-ownerships and non-incorporated ones. In other words, the arbitrary figure of 20 co-owners has divided the business world into two sectors,

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97 Supra, note 78, p.456.

the incorporated and the unincorporated.

Another division according to the number of owners is that of companies with fewer or more than five controlling owners. Although theoretically this division is not exclusive to private companies, because of the "control" element, in reality it is only they that are affected by it, and not the public companies. The responsibility for the creation of this type of company rests with the tax authorities[98] who aim to prevent tax evasion schemes. Being a corporation with a close affinity between ownership and control, it is referred to as a "close company".

The ownership criterion has been used in the UK legislation for differentiating between incorporated and unincorporated forms of trading, and between corporations with a close link between ownership and control. Prima facie the unincorporated forms of trading and the close company seem to be small, owing to the small number of their owners; but as already elucidated this observation is invalid in reality. Consequently no link can be established between the number of owners and a small business.

(iv) The Ownership Criterion in the Legislation of Israel

The main forms of ownership practised in Israel, besides the natural one of sole ownership, are the partnership, the company, the co-operative and the kibbutz, all of which may relate to small and large units. It is proposed to examine whether the legislator has provided for the differences in their sizes, in addition to their different legal forms, and whether ownership is considered a criterion that can reflect such size differentials.

Israeli ownership patterns are unique, in that they embrace the extremities of the capitalist and communist economic philosophies, a

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98 The Finance Act 1922.

phenomenon not paralleled in any other country. At the one extreme, the capitalist, is found the company, the archetype of aggressive capitalism, and at the other extreme, the communist, is found the kibbutz, a structure based on stricter principles of communal sharing than the kolkhoz in Russia or the commune in the People's Republic of China.

As regards co-operatives, though these, unlike the kibbutz, are not an Israeli invention, and are practised in other socialist and capitalist countries as well, their Israeli brand is special because it has been used for all conceivable purposes and by all the different prevailing ideologies from socialism to capitalism. One possible reason for their intensive use there is the special economic and security situation of the country, where labour and finance are in short supply, and where workers have to be replaced at short notice because of military call-ups. Under such conditions the co-operative movement has expanded not merely for ideological reasons, but also because of the practical considerations of everyday management and financial problems that besiege a commercial enterprise. A business form such as a co-operative, which demands a greater sense of responsibility and sharing from its members than that required by the capitalistic relationship of employee/employer, seems to have been the solution.

(a) The Partnership

The Israeli partnership is regulated by the **Partnership Ordinance (New Version) 1975 (5735).** The new version replaced the **Partnership Ordinance 1930,**[99] which succeeded the Ottoman Commercial Code with regard to commercial partnerships, while agricultural partnerships and joint ownerships continued to be regulated by the Ottoman Civil Code, the "Mejla".

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99 Laws of Palestine, Vol.B, Ch.103, p.1020.

A partnership is defined as the relationship between persons who together manage a business with a view to making profits, and which business is not a company or another form of incorporation.[100] The membership of the partnership is not restricted to individuals, but can include corporate bodies as well. The difference between the Israeli partnership and the English one is the registration of the Israeli partnership and its consequent status of a separate legal entity. Section 4 of the Ordinance obliges a partnership which is intended to manage a business to register within a month of its formation (with the exception of a partnership between farmers in connection with the cultivation of land). Though non-registration does not count as a decisive factor when determining the existence of the partnership,[101] it penalises each partner by making him personally liable to a fine of IL15 for each day that the offence continues.[102]

This need for registration has originated in the notion, which the courts have supported, that the registered partnership is a separate legal entity to its members,[103] though the ordinance does not express this in so many words. A further point in support of the argument that the Israeli partnership is a separate legal entity is Section 6, which states that non-registration does not invalidate the partnership. Thus the

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100 Sec.1(a).

101 Sec.6.

102 Ibid. (IL15 is at the October 1980 rate roughly equivalent to 9p, which is a ludicrously small amount, without any punitive meaning. This is an example of legislation that has not been altered to match the inflation rate. Had it been provided with an automatic indexation clause, such a fine would have adjusted itself automatically and remained meaningful.)

103 Banco Di Roma v. The Israel Company for Zinc Products "Deli" and others, CA 107/36 PLR 58, p.4;
Sharel v. "Magdan" Ltd., CA 117/47, PE p.189;
Tenenboim v. Nahum, CA 94/56 PE 25, p.334;PD 10, p.1602;
Fridman v. Fridman,JK T-A 26/46 PM 6, p.315;
Voortzel v. Peretz & Partners, CA 6/53 PM 5, p.462, which was upheld in CA 251/53 PD 10, p.198.

difference between the legal status of a registered and that of a non-registered partnership is the former's "legal personality" which the latter lacks.[104]

The maximum number of partners in a partnership is 10,[105] and all the members of an incorporated legal body are counted as one. The number of the partnership members has not been altered or challenged since the inception of the trading form in 1930, nor has it caused a dispute calling for the court's intervention. However, the attachment of a separate legal status to "registration", together with the ceiling of 10 partners, could cause some complex situations. For example, would a correctly registered partnership with 10 members, following an eventual increase in its membership beyond the permitted maximum, lose its status of an independent legal entity and be considered to be an unregistered partnership? Or would the relationship between the original 10 registered members be considered as having created a separate legal entity, while the new partners would be treated as having entered into an agreement with that separate legal entity? And what would be the legal responsibility of the additional partners? Would the original 10 members hide behind the legal façade of the independent partnership, and the excessive members be personally responsible?

In the references made by the **Income Tax Ordinance (New Version) 1961 (5721)**[106] to partnership, there was no mention of the ceiling of 10 partners which was imposed by the **Partnership**

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104 Emek Hayarden Undertakings v. The Property Tax Commissioners at the Treasury and others, HC 29/61 PD 15, p.1246; The National Insurance Office v. Salim Alias Kuri Perah, LTA (Labour Tribunal Appeal) District Court Jerusalem 24, p.100; Vigodeski Varf v. Harper, CA 147/48 Hamishpat, 1948, p.448.

105 Sec.3.

106 The new version replaced the 1947 Income Tax Ordinance.

Ordinance, because it defined a partnership as "two or more persons engaged in an enterprise or a trade",[107] without resorting to a maximum numerical limit. Thus it seems that according to the **Income Tax Ordinance** a partnership has an unlimited number of members, whereas according to the **Partnership Ordinance** it is limited to 10.

The tax authorities have not acknowledged the separate legal entity of the partnership, and its earnings are allocated to each of the individual members. Owing to the fact that the tax authorities have ignored the legal entity of the partnership, the advantages of the registered partnership as a separate legal entity are limited to the protection of its members from legal proceedings involving imprisonment, and the ease of registration in comparison with that of a company. It could be said that the registered partnership with a maximum of 10 partners was intended to serve as the small man's private company, as the maximum number of 50 shareholders in the private company proved to serve also large and not just small businesses. Because the Israeli partnership, like a company, can limit the responsibility of its members,[108] it is a most suitable business form in the context of the small size of the Israeli economy and the large numbers of very small businesses there.

(b) The Company

The Israeli **Companies Ordinance 1929**,[109] which is responsible for the regularisation of all aspects relating to companies, has been copied from the British **Companies Act** of the same year with minimal

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107 63(a).

108 The Partnership Ordinance, Secs.56, 57, 58.

109 Laws of Palestine, Vol.A, pp.155, 161(a) (as amended).

differences.[110] With the creation of the State of Israel as an autonomous State in 1948, the links with British company law have been severed as regards any legislation and precedents which took place after this date. When references to the British company law are made, these are only to legislation and cases prior to 1948. Later British legislation or court decisions might be of influence, but are not binding on Israeli courts.

The **Companies Ordinance** takes over where the **Partnership Ordinance** leaves off, and states that any trading group with more than 10 members has to register as a company.[111] The aim of restricting the number of partners was to force large groups of traders to manage their affairs from within the formation of a company, thus creating a means for controlling and supervising large-scale trading for the benefit of the public.[112] The limitation of the number of partners has caused great difficulties to the free professions of accountants and lawyers, who are barred from incorporating by the legal restrictions imposed on their professions. This causes the splitting of successful and expanding associations, and the starting of new ones, which increases the already large number of small professional enterprises there. One way to overcome this restriction is to create a separate partnership that joins the original one later on, because for the calculation of the number of partners, another legal body such as a partnership counts as one partner, regardless of the number of its members.

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110 The Companies Ordinance 1929 succeeded the Companies Ordinances 1919 and 1921, which in turn succeeded and cancelled the Ottoman Company Law that regulated such affairs in the area then known as Palestine, which was part of the Ottoman Empire.

111 Secs.25(a), 25(b).

112 Smith v. Anderson (1880), 15 Ch.D 247, "... to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies, so that persons dealing with them did not know with whom they were contracting, and so might be put to great difficulty and expense, which was a public mischief to be repressed."

Other laws that have enforced trading through the legal institution of a company are the **Banking Ordinance 1941,**[113] the **Israel Bank Law 1954 (5714)**[114] and the **Encouragement of Industry Law (Industry Betterment Taxes) 1969 (5729).**[115]

(c) The Private Company

The private company[116] was introduced into the 1929 Ordinance via Amendment No.1 in 1937. It is a company whose articles restrict the transfer of shares, limit the number of its members to 50, excluding employees and ex-employees, and forbid any share offer to the public. This definition is identical to that of the UK **Companies Act 1948** (which repeats an earlier British definition on which the 1937 Palestine Mandate definition was modelled).

The few advantages that the law has granted the private company have been eroded by the introduction of the close company.[117]

(d) The Close Company

The Israeli close company was the creation of the **Income Tax Ordinance (New Version) 1961 (5721),**[118] which was preceded by the **Income Tax Ordinance 1947.**[119] A 1968 Amendment defined a close company as a company which is controlled jointly by a maximum of five persons, and which is not a public company or a subsidiary.[120]

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113 Sec.2.

114 SH 164, 1954 (5714), p.192, Sec.1.

115 SH 606, 1969 (5729), p.152.

116 Secs.25(a) and 25(b).

117 In Hebrew, "Hevrat Hame-atim".

118 The new version was promulgated in the Laws of the State of Israel 6, 1961 (5721), p.120.

119 YR 1947 Supp.1, No.1568, p.93.

120 The Income Tax Ordinance (New Version) 1961 (5721), Sec.76(a).

The elements of the definition are:

1. a company that has five persons or fewer;
2. joint control.

"Control"[121] is given the wide meaning of a joint ownership or a right to acquire the majority of (a) the share capital; (b) the voting power; (c) the issued share capital; or (d) the ownership of a shared right to acquire that part of the share capital that entitles, in case of the division of the company's income, to the majority of that sum.[122]

For the purpose of counting the five controlling persons, the following are considered as one:

1. A person and his spouse, brother, sister, parent, grand-parent, offspring, offspring of one spouse, and the spouse of each of them.
2. A person and his representative.
3. Parties in a partnership.

Although the **Income Tax Ordinance (New Version) 1961 (5721)** relates only to five "persons", according to Section 1 of the **Interpretation Ordinance**, this also includes corporations.[123]

Notwithstanding the similarity of the Israeli and the English definitions, they are different in their interpretation of "control". The Israeli definition, unlike the British one, does not distinguish between participants and directors, and the "control" can be vested in any person, and not necessarily only in one of them. This facilitates the task of the Israeli Income Tax authorities who consider the income of the close company as that of its shareholders, and tax them as if they were a partnership and not an incorporated body. Their task has been made

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121 Ibid., Sec.76(b).

122 Ibid.

123 Shelush v. Jacob Yefet Incorporated Ltd., CA 382/67 PD Vol.22, p.133.

easier still by the Courts, which have gone even further, and compared not only the income of the close company with that of a partnership, but also its property. This has eroded any remaining difference between the private company and the partnership, especially as some of the advantages of the limited responsibility could be attained also by the limited partnership. In **Hillel Dan v. The Inland Revenue**[124] Judge Levenberg said, "The company is surely a private one, as it had only four or five bodies which held all the shares. It might even be a close company whose property is tantamount to the property of the shareholders."

(e) The Family Company

The latest innovation in the type of Israeli companies is the "family company".[125] Although the term has been accepted in many countries for a long time as a description of a specific socio-economic unit, it has not been defined by legislation in any of the researched countries. Sec.64(a) of the **Income Tax Ordinance 1961** states that a "family company" is a company whose members are mentioned in the definition of "family" by Sec.76(d)(1),[126] which is the very same section that defined the meaning of "family" for the purpose of specifying the identity of the five "controllers" of the closed company.

The family company is a voluntary institution, since it has been left to the company to elect to be treated as one. It was created in order to reduce the tax burdens on those small companies who, as a result of the enforced profit distribution of the close company, are confronted with double taxation on the profits of the company and on the enforced issued dividend. As to why the legislator has favoured only

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124 Hillel Dan v. The Inland Revenue Commissioners ITA T-A 197/64, The Inland Revenue Edition of PD, Vol.5, Booklet 2, p.42.

125 The Income Tax Ordinance 1961, Sec.64(a).

126 The Income Tax Ordinance 1961.

family companies with this privilege, and not the entire close companies sector, is not clear. The concession given to the Israeli family company is similar to the one granted in the USA to the elected small business corporation, the difference being that there the privilege is not related to a blood relationship but applied to any corporation with fewer than 10 shareholders.

The family company relies on the qualitative facet of the ownership criterion, since it raises the question of who owns, and not how many own. In effect the family company could consist of a whole clan, in which case the number of owners could easily exceed the five members of the close company. In some situations it might even exceed the ceiling of the 50 shareholders of the private company, and create an anomaly by which the tax authorities consider a public company as a family company and permit its shareholders' income to be taxed directly and not via the channels of Corporation Tax.

(f) The Israeli Companies - Summation

Prior to 1937, the law in what was then Palestine recognised only one type of company. In 1937, the private company with an ownership restriction of 50 shareholders was introduced. In 1968 the **Income Tax Ordinance 1961** (as amended) unveiled the close company with five controlling persons, and in 1978 it created the family company, which is restricted not in the number of its owners but in their familial connections.

Each of these three types of company has been originated with the small enterprise in mind; the first in order to protect it, the second in order to attack it, and the third in order to save it from extinction. Yet not one of the effecting legislation has named it in so many words. They have preferred to use terms like "private", "close" and "family" rather than "small".

(g) Co-operatives

The co-operative as a form of trading is used extensively in Israel. In comparison with the size of the country, it is more commonly employed than in the USA or the UK, though less than in the People's Republic of China. Yet it has been established for a longer period than the Chinese co-operative, and has been legislated for in greater detail. **The Co-operative Societies Ordinance 1933,**[127] which is the legislation responsible for the existence of co-operatives in Israel, was based on the Indian **Co-operative Societies Act 1912**, which was modelled on the English **Industrial and Provident Societies Act 1893.** The ordinance was intended to embrace a variety of co-operative societies ranging from those of producers, consumers and housing, to provident pension funds and health insurance schemes.

A co-operative is defined as an association whose aims are the promotion of: saving, self- and mutual help between persons with joint economic interests in order to ameliorate their standard of living, businesses and their production methods.[128] Such a co-operative is considered a separate legal entity and can have a limited or unlimited liability.[129]

The maximum number of members in a co-operative is unrestricted,[130] but the minimum is seven.[131] This restriction on a smaller

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127 Laws of Palestine, Vol.1, p.336, 360(a); Amdts. YR 660, 1937, Supp.1, p.1, 1a; YR 1380, 1944, Supp.1, p.125, 171(a); SH 79, 1951 (5711), p.221, SH 377, 1962 (5722), p.107.

128 The Co-operative Societies Ordinance 1933, Sec.4.

129 Ibid.

130 The textual wording of Sec.2 does not specify that the maximum number of members is unrestricted. But this is understood from the existence of a lower threshold without an upper one.

131 Sec.2.

number than seven members indicates that the co-operative was not intended to serve as a legal form for small businesses. This opinion is also supported by the **Income Tax Ordinance (New Version) 1961 (5721)**, Sec.129, which grants co-operatives with large numbers of members tax exemption on part of their incomes.[132] Since it seems that this form of trading has not been designed for small businesses, it cannot further the aims of the present research.

(h) The Kibbutz

The kibbutz is a type of agricultural settlement regulating itself on the principles of communal ownership. Prof. Weisman regarded it as "a voluntary organisation set up to serve the Zionist goal of the agricultural settlement of the Jewish Homeland and not a means to secure the individual's economic interests".[134] The kibbutz is more than just a communal settlement like the co-operative farming villages such as the kolkhoz of the USSR or the Chinese commune, which are based on the principles of communal ownership and utilisation of the means of production, for which the members are paid, either in relation to their output or according to their needs, depending on the political climate of the time,[135] and who on occasions have even been allowed to engage in some private enterprise designed to augment their income.[136] The

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132 The Income Tax Ordinance (New Version) 1961, Secs.129(c)(1)(a), 129(c)(1)(b), 129(c)(1)(c).

133 The Hebrew meaning of "kibbutz" is a gathering or community. The plural is "kibbutzim". Sometimes they are referred to in the feminine as "kevutza", the plural of which is "kevutzot".

134 J. Weisman, "The Kibbutz: Israel's Collective Settlement", Israel Law Review, 1966, Vol.1., No.1, p.100.

135 The People's Republic of China has gone through several ideological changes as regards remuneration for work, the most recent of which were the Cultural Revolution and the rule of the "Gang of Four", during which the principle of "to each according to his needs" prevailed. With their banishment and the more liberal regime of Chairman Hua, this attitude has been replaced by "to each according to his work".

136 F. Belov, The History of a Soviet Collective Farm, Routledge & Kegan Paul, London, 1956, pp.87, 176.

communal way of life of the kibbutz is different, both from the ideological and from the practical aspects. Its members join it voluntarily, without physical or moral duress, in order to fulfil a dual calling - the national one of working the land of Israel, and the socialist one of sharing ownership. They are not paid; nor are they allowed to use their spare time for financially remunerative occupations. In turn, the kibbutz looks after all their needs. In everyday life, this expresses itself in the form of a central pool of labour, which caters for all the physical needs of its members, from eating, clothing and laundry, up to the rearing and educating of the members' children. Members are entitled to an extremely small yearly allowance, the size of which is determined by them collectively.

From a socialist doctrinal outlook, the kibbutz practises an advanced stage of communism, "from each according to his ability and to each according to his needs"; but it adds also another dimension, which is not postulated in communist teaching: the communal way of life, in the true sense of "communal". The kibbutz way of life is reminiscent more of that of a religious monastic order, than of a communist undertaking. On entry, the member gives all his worldly possessions to the kibbutz, and during his membership any earnings which he is entitled to personally from external sources belong to the kibbutz. Should he leave, he cannot take out with him any property, because according to kibbutz regulations the individual member is devoid of any ownership rights except on his personal belongings. From this aspect, membership of a kibbutz is totally different from membership of a company or even of a co-operative. The similarity between the ownership patterns of a monastic order and that of a kibbutz is striking.

(h.1) The economy of the kibbutz

Initially the kibbutz functioned purely as an agricultural settlement, but now that some have grown to a large size they have acquired economic ambitions and branched out into industry. The industrial sector of the kibbutz is meant to serve its social and economic needs. From a social point of view it offers workplaces to the older population who are no longer gainfully or even physically able to work on the land, and to the younger generation who are looking for more interesting occupations; while from an economic aspect it stabilises the see-saw fortunes of agriculture.

The transformation of the kibbutz from a purely agriculture economy to a mixed one, has increased the need to conduct it as a viable business enterprise. Market trends have to be followed, orders filled, and any insufficiency in the labour force supplemented by the employment of outsiders, for whom taxes, like PAYE and national insurance, had to be paid. In short, the kibbutz has developed into a business enterprise, if not as regards its internal management, yet definitely regarding its external affairs. Today the kibbutz is a hybrid of a business enterprise and a monastic order. The question arises of whether this has altered its members' rights to its ownership, and whether the number of members has any effect on the Kibbutz's legal rights and duties.

(h.2.) The kibbutz as a form of incorporation

The kibbutz has adopted the legal form of a co-operative society as per the **Co-operative Societies Ordinance 1933**, which catered for most variations of co-operatives, each of which had its own rules, which had to be registered with the Registrar of Co-operative Societies.[137] On registration as a co-operative society, the kibbutz becomes a separate legal entity, enjoying all the advantages of

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137 Co-operative Societies Ordinance 1933, Sec.8.

incorporation, such as limited liability, continuity, etc.[138]

The rules of the kibbutz have been found by Professor Weisman to be inadequate and to misrepresent its way of life and practices.[139] The incompatibility between the legislation regulating the kibbutz and the actual practice carried out in its relationship with its members, have been commented on by the Courts:[140]

> "To this very day - in the twelfth year of Israel's independence ... it is still necessary to decide matters concerning the special way of life of the kibbutz and the norms governing it - as well as the legal results of a clash between the kibbutz world and the 'outside' world - by legislation which did not take into consideration the possibility of a body like the kibbutz, and by inadequate standards ... I wish to express my surprise and regret that no steps have been taken and no initiative has been shown either by the Government or by the kibbutz movement to define the position of the kibbutz and its members vis-à-vis the 'outside world'. This is a difficult problem for it does not only entail the rights of the kibbutzim and their members, but the liabilities of the kibbutzim and their responsibility for the debts of their members as well."[141]

It seems that because of its uniqueness, the scarcity of legal actions brought against and by it, and the national aspects involved, the kibbutz has managed to exist without a comprehensive legal system regulating such fundamental aspects as the ownership rights of its members, let alone legal differences between a kibbutz with a large number of owners and one with a small one. The more established the kibbutz movement becomes, the more pronounced becomes the difference between the various kibbutzim. The more established ones usually become the larger and more prosperous ones and just as in business, economies of scale sometimes affect the viability of an enterprise. Hence it is impossible to say that a "kibbutz is a kibbutz is a kibbutz", regardless of its size or the number of its members.

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138 Ibid., Sec.21.

139 Supra, p.116-118, note 30, p. 438.

140 Nissim v. Abu Kishek (1960), 22 PM 22.

141 Ibid., Judge Harpazi.

(i) Summation

The quantification of ownership by the Israeli legislation can be divided into three categories:

The first is intended to ensure that certain forms of trading are used by small businesses.

The second is meant to bar small enterprises from using certain trading forms thought to suit the larger businesses; and

The third is aimed at preventing small undertakings from using tax planning schemes.

The first category includes two commercial forms, the partnership and the private company. The former is restricted to 10 owners and the latter to 50.

The second category covers two other forms of trading, the co-operative and the kibbutz, which is regulated by the same legislation as the co-operative; this uses an ownership qualification of seven as a lower threshold, creating an entry barrier to small undertakings with less than the required number of seven owners.

The third category has created the "close" and the "family" company. The first is restricted to a maximum of five owners, while the second does not rely on a numerical determinant.

The quantification of the number of owners of the various trading forms has not always achieved the aims for which it was in each case designed. As regards the partnership, it could be said that the limit of 10 owners has acted as a double-edged sword. On the one hand it has ensured that large groups of owners are excluded from this business form, but on the other the inflexibility of the numerical determinant has caused professional associations such as those of lawyers and accountants to curtail their growth and has forced them to split up into small units.

A lot can be said for the curtailment of monopolies and their splitting

up into small units, but the enforced division of professional partnerships with more than 10 owners cannot be similarly viewed. Israeli legislation has not followed the British pattern, which exempted certain professions, which were prohibited by their profession's regulations from incorporating, from the numerical ceiling imposed on the partnership.

The private company is an example of the drawbacks inherent in the quantification of ownership. It was introduced into Israel during the British Mandate and was an exact replica of the English private company[142] with a restricting ceiling of 50 owners.[143] Fifty shareholders, in the context of the British economy, might have portrayed a smallish enterprise, but not so in Israel, where such an upper threshold prevents only a handful of companies from calling themselves "private". By ignoring local conditions, the legislation has rendered the 50-shareholder threshold devoid of meaning.

The co-operative imposes an entry requirement of a minimum of seven owners on those wishing to use this form of operation. Whether it was wise to exclude small undertakings from using a commercial form most suited to their needs, particularly in the conditions of Israel, where high wages, high rates of employers' social contributions, and very strict employment regulations have made it difficult for small businesses to survive, is debatable. The trading form of a co-operative could have eliminated all the small businesses' mentioned constraints, since co-operative members do not create employer-employee relationships.

The kibbutz is an institution apart from the rest, for its raison d'être is not just that of a co-operative - the improvement of its members' lot - but also the fulfilment of a national calling which is the settlement of Israel. This last reason would make it impractical

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142 Companies Act 1948.

143 Ibid.

for a kibbutz to have fewer than seven members.

The close company has to be judged from the tax authorities' point of view, as it is their creation. As far as they are concerned, the limitation of ownership to five has excelled in its task, for it has included a great number of companies within its jurisdiction. In comparison with the UK and the USA, where the same figure of five owners was a determining factor in forcing the distribution of corporations' profits, the number of Israeli companies that were caught in the web of the close company is considerably greater than in the other two countries, because the majority of Israeli companies are of this nature and size.

It seems that the only legislation which has achieved its intended aim is the tax legislation which created the close company. It must have succeeded to such an unexpected degree that the legislator had to introduce the "family company" in order to halt the genocide of small enterprises caused by the high taxation that resulted from close company status.

Conclusion

Ownership is the basis of all business forms, for invariably someone or some persons own part or all of any business. This dictum is applicable to a sole ownership, a partnership, a company, a Chinese commune or an Israeli kibbutz, but that does not prove that it is an appropriate criterion for the definition of small businesses.

The dilemma of having to decide whether the quantification of ownership is essential for a small business definition stems from the contradiction between the law and reality. Legislation has used quantified ownership time and again as a size indication of an enterprise, while commercial reality renders such quantification, absolutely invalid: it is and has long been a known fact that very large businesses are often

operated under the ownership of a single individual or a small group of owners. The validity of this argument cannot be contested, but the question is whether it is meaningful enough to allow the dismissal of numerous acts of legislation that have relentlessly stuck to the criterion of ownership as a definer of the small size of a business. However, a simpler solution would be to claim, as is often done, that these anomalous large businesses must be only the exception to the rule, and that the majority of small businesses are owned by a small number of owners, as indeed they are, and therefore ownership is a valid criterion in their definition.

Prima facie, ownership is a good criterion for such a purpose. First of all, it is a "certain" criterion, as are all criteria which rely on human elements such as employees, customers, and subscribers. Secondly, as already mentioned, it is the common denominator of all trading forms - something that cannot be said about a criterion such as employees, who do not exist in certain forms of co-operatives. Among the limitations of ownership as a definer of small business, is the fact that it appears to represent the capitalist side of business to a greater extent than employees represent the socialist one. This assertion is based on the argument that the numerical strength of employees in any given enterprise depends on the discretion of the owner(s), whereas it is rarely that the number of owner(s) depends on the discretion of the employees. Yet this limitation can be offset by the criterion's advantages as a universal instrument.

Nevertheless, efforts to establish the merits or drawbacks of ownership as a criterion for a small business definition, are only a digression from the main issue of whether the quantification of ownership is actually essential to a small business definition, and whether the definition would be lacking without it. In order to reach a

conclusive answer, it will be necessary to test the legislation that has used this criterion in the arena of present-day reality, and to ascertain whether the need to quantify the ownership criterion which existed at the time of legislation, is still valid in 1980.

The partnership. In the UK the partnership is limited to 20 partners, in Israel to 10, in the USA it is not restricted and in the People's Republic of China it its extinct. In both the UK and Israel the aim of the restriction was to safeguard the public by imposing on any large organisation the constraints of company law, which demanded adequate disclosure and control. This was wholly aimed at protecting the unprotected public; but the public of 1980 is not defenceless. Employment and consumer protection legislation now protect employees and consumers regardless of an enterprise's number of owners. And as to the commercial community, it was not the legislations' intention to look after that, for it has never been considered defenceless.

In the UK, the ceiling on the number of partners has been lifted as regards certain professions such as lawyers, accountants, surveyors and architects, but Israel has not followed suit. Thus the argument against the UK restriction is that by exempting the only associations that have to operate as partnerships, namely the free professions, the restriction of 20 partners has been left toothless.

The private company does not rely exclusively on the quantification of its owners for its definition. In the UK the private company is no longer limited in the number of its owners. In the USA the close corporation, which is the nearest form to the UK's private company, does not rely for its definition exclusively on the quantity of its owners, and in some States it is not even a joint criterion. In Israel, where the ceiling of 50 shareholders is still a requirement for private company status, it is not an exclusive condition of the definition. Not

being an exclusive criterion of private company legislation, and sometimes not even a joint criterion, it seems that the ownership criterion is not essential for the definition of a private company.

The "close" and the "closely held" companies. The ownership criterion, as used by the tax-created companies, has never been intended to define a small business per se, but only to exact higher taxes. Such aims can be and have been served by diverse methods, other than through the medium of the "close company" or the "closely held" corporation. Thus, even from the revenue collection aspect, this type of tax company, with a five-owner limitation, can be defined by other criteria as well.

The co-operative. The Israeli co-operative is the only co-operative that is restricted in the minimum number of its owners. If the legislator was intent on ensuring that this form of trading should not be used by the very small enterprise, then by employing the lower threshold ownership determinant of seven members, he has managed to achieve his aim. Co-operative membership in the UK, the USA and the People's Republic of China is not restricted, either in its maximum or its minimum number of owners.

The kibbutz is a unique Israeli legal structure. The Chinese commune and the Russian kolkhoz are its nearest equivalents, but not exact replicas. The kibbutz falls within the same category as the co-operative, because it is regulated by the same legislation, and therefore the seven-member lower threshold restriction applies to it as well.

Testing the effectiveness of the quantified ownership criterion as a definer of small businesses in the reality of 1980 has shown that when it has been used as an upper threshold it has been ineffective and has failed its allocated tasks, and could have been replaced by other

criteria; but when it has been used as a lower threshold, it has managed to achieve the aim of barring small businesses from using that specific form of trading. As a result, it can be concluded that a small business definition can manage without the criterion of ownership.

PART FOUR

THE DEFINITION

CHAPTER SIXTEEN

DEDUCTIONS

Introduction

Definitions are merely the formulation of the definer's opinions as to the defined's characteristics. And opinions can be ignored, agreed or disagreed with. Not all studies research the opinions of others. Those that are based on primary observations do not have to contend with pre-established opinions, and consequently are not faced with the task of approving or contesting them; but a study of the definition of the small business, which is mainly concerned with the opinions of juristic and administrative definers as to what signifies a small business, evolves from their opinions. While the opinions of juristic and administrative definers can be agreed or disagreed with, they cannot be ignored, because theirs - unlike other definitions - are incorporated within legislations that affect the defined. Yet it is also impossible to agree or disagree with them completely, because each proffers his own definition of the small business. What is possible, nevertheless, is to reject the present state of affairs whereby each legislative act determines its own criteria for the definition of small businesses, and to formulate a definition to which all juristic and administrative definers might subscribe, and which could then be accepted as a universal unitary definition of small business.

The results of disagreement are different from those of ignorance or agreement, because while ignorance is an inactive state requiring no action, and agreement involves repetition of others' actions and opinions, disagreement precedes the active state of creation: one ought to disagree only if one can offer a different solution to a problem, or a different definition of a phenomenon. Hence it might be expected that a definition that has been born out of disagreement with others should

be innovative in context or form; otherwise the reasons for the disagreement would be obscured. It is therefore often an anti-climax when the offered solution is not revolutionary in concept or structure. But then legal solutions are mostly compromises and are rarely revolutionary, as they have to be functional and fit into an existing system that is not geared to accommodate radically different components. Consequently a new small business definition will have to take into account not only the factors that constitute the defined, but also some that do not relate directly to it, but which can affect the practical application of the definition within the legal system.

(i) Small Businesses Exist

The question about the existence of small businesses is the elementary dilemma of how can it be known that something exists if its nature is unknown. How can it be ascertained whether small businesses exist, if what they are is not yet agreed upon? The existence of tangible objects can be easily proven by physical means of sight, touch and feel, while the existence of an abstract phenomenon such as small business is usually proven by referring to the consensus of opinion that claims that it exists. Agreement that something exists is the most convincing proof of its existence, though not necessarily the most accurate.

In the case of small businesses, their existence is affirmed in three ways:

(1) by the actual reference to them as "small business";[1]

(2) by the criteria which are used to define them and which are associated with small size, such as small number of employees, or low turnover figures; and

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1 See pp. 88, 95, 136, 141, 267, 308.

(3) by the existence of legislation that refers to them, either directly or indirectly.[2]

References in legislation to small businesses are the most conclusive evidence of their existence, because usually legislation does not innovate, but confirms existing attitudes and opinions.

(ii) Small Business Is a Type of "Business"

The knowledge that small businesses exist does not however explain what type of phenomenon small business is: whether an independent entity or a sub-group of the wider category of business. Had objective criteria to determine this existed, no such question would have arisen; but in their absence it is necessary to rely for such a determination on circumstantial evidence: in this case the type of criteria that have been hitherto used for the definition of small business by juristic and administrative definers.

Usually it is customary for an independent concept to be defined according to qualitative criteria, and for its sub-group according to reductive quantitative ones, but there are situations whereby a sub-group merits an exclusive definition of its own - as is the case with small business - whereupon qualitative criteria will be employed for its definition. The proof that small business is not an independent concept divorced from that of business is the fact that no legislation has relied exclusively on its qualitative aspects, which it would have done had the legislator considered it to be an independent concept. Therefore, since small business is a sub-group of business, its definition is tied to that of business, and this will have to be done first before more progress can be made.

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2 See Chapter Five, p. 88-97.

(iii) The Definition of Business

A sub-group has to satisfy the definition of the main group before it complies with its own. This applies to any sub-group, whether its definition is based only on reductive quantitative criteria, or on different qualitative criteria from those of the main group.

"Business" is acknowledged to mean a commercial enterprise, and as such its definition is based on the following commercial aspects, without which it cannot operate:

1. An ability to manufacture a product or supply a service.
2. An ability to supply a demand.
3. An ability to exchange the product or service for money or different products or services.

These three major elements encompass the overall activities and functions of business. Other elements which are associated with business, but which have not been singled out as major components, are employment, profit and ownership.

Employment was omitted because although it is an element of production, it is not a necessary element at all the stages of a business's existence. For instance, at the initial stage of a business, the work can be undertaken by the owner and his family, which would mean that no employment of others took place. Since enlisting the services of oneself or one's close family does not count as employment, even in the People's Republic of China,[3] a business can function without the element of employment being part of it.

An alternative explanation for the omission of the employment criterion is that it is a hidden element of the "ability to manufacture or supply a service" and therefore does not have to be isolated.

Profit is another element which is often correlated with business;

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3 See pp. 111-121.

in fact it symbolises its raison d'être. It was, however, not incorporated among the major components of a business, because it is included within the wider element of "exchangeability". In fact profit as such is not an essential part of a business, because the chief aim of any entity is its own perpetuation, and not the satisfaction of its originators, or dependents.

As long as the exchange value of its products enables the business to continue, profit is immaterial to its existence. The reasons that businesses do, however, concern themselves with profit despite its irrelevance to themselves, is that it is the motivating force of their owners, who might abandon the business if their desire for profit were not satisfied. The most conclusive proof that profit is not an essential element of business is the fact that many businesses do not show any profits, yet they continue to exist.

Ownership, like employment and profit, is not a component of business because the identity of the owners or the form of ownership does not affect its survival. A business can be owned by any, some, or all the human elements that come in contact with it; the consumers who require the product; the labourers who produce it; the financiers who sustain it; or the management that co-ordinates them. When it is owned by the consumers, its business form is a consumers' co-operative; when by labour, it is a workers' co-operative or commune; and when by finance and management it is a corporation; and when by all of them, it is a public corporation. The identity of the owners and the form of ownership affect the business's aims and methods of operation, but not its survival.

A business relies on three factors for its existence - "production", "demand" and "exchangability" - and on a fourth, "a voluntary workforce", for its differentiation from forced labour undertakings, which might share all the other three factors, yet are not businesses per se.

Production, being inclusive of the supply of services, is self-explanatory, as without it no "demand" can be fulfilled and no "exchange" can take place. It consists of labour, know-how, materials and machinery, and is a common factor of all workplaces irrespective of whether they are commercial enterprises or not, while the elements of "demand" and "exchangeability" are unique to enterprises with commercial aspects.

Workplaces whose production is not geared to "demand" but to the fulfilment of their workers' social and therapeutic needs, cannot be considered businesses, though their products may be "exchangeable". Likewise workplaces whose production fulfils a demand, yet is not "exchangeable," for example the production of armaments by a nationalised industry during wartime, cannot be counted as businesses. As regards workplaces that fulfill all three requirements, "production", "demand" and "exchangeability", but are based on forced labour, such as prisoners, these cannot be referred to as businesses, because they are not bound by the prevailing labour laws regulating remunerations and social conditions. This gives them an in-built advantage over the commercial enterprises. It is also an unacceptable violation of human rights.

A definition of business will therefore have to consist of these four elements, and will read as follows:

"A business" means a voluntary workforce engaged in the supply of products or services for which there is a demand, and which are exchangable for money, commodities or services.

This definition excludes:

1. Enterprises based on forced labour, such as those employing prisoners.

2. Enterprises which do not supply a demand, such as therapeutic workshops in hospitals.

3. Enterprises belonging to the armed forces, which produce weapons whose resale is prohibited.

The definition does however include illegal enterprises. For instance, drug-trafficking is a business, because it employs a voluntary workforce engaged in the supply of a product for which there is a demand, and which can be exchanged for money or its equivalent.

The definition of business is invariably a qualitative one, because it defines a major group; whereas the definition of a small business, being a sub-group, ought to be at least in part quantitative, because usually the differentiation between a major and secondary group is a question of degree and not of essence.[4]

(iv) Small Business Is Invariably Small

Though the definition of "business" is valid for all sizes of enterprises, big, medium and small, small business maintains that it justifies a definition of its own. Usually the most prominent and easily recognisable differences are the external ones, and an outwardly small business is indeed different from other types of business on account of its smaller size. The smallness can express itself in all or some of the four elements incorporated in the definition of "business"; in a smaller workforce, production, demand and exchangable value. If all four elements are smaller, then the classic small business is encountered, but even if just one element is smaller than the norm, the enterprise is deemed to be small.

The size of a business, like all other measurable characteristics, means a compliance with or variation from a given norm; the norm

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4 See pp. 189-190.

being the average, which is variable in itself. Among businesses the norm ought to be the medium-sized enterprise, and any significant deviation from it should result in a classification as big or a small business. When any of the four business elements deviates by decreasing from the norm, the business ought to be considered small.

There is no doubt that size affects the character of an enterprise. A size reduction of one factor is sufficient to affect the overall structure of the enterprise. For instance, a small workforce requires different managerial skills than a large one, and smaller financial resources. It produces less and therefore sells less. Another example of how a size reduction of a factor affects the total character of the business is that of reduced production, which requires less machinery, fewer workers and less finance, and which results eventually in reduced sales and income. Thus it can be seen that a reductive deviation from the norm even of one factor compels the business to be treated as small, because it invariably causes the reduction of all the other factors that make up the business.

(v) Small Business Is a Phase

Further proof that small business is a secondary phenomenon and not a major one like business, is that it is a phase through which most businesses go. It was customary for all businesses to start small, but this is no longer so, owing to the great advances in communications and transportation methods which facilitate the transfer of knowledge and equipment from established businesses to new ones, thus enabling the latter to bypass the phase of smallness. Still, the majority of independently owned businesses, commence as small.

Smallness is not limited only to the initial stages of a business's existence, for some enterprises never grow out of this phase, and others revert to it. It is therefore a transient phenomenon, while "business" is a constant one.

(vi) Small Businesses Are Not Affected by the Size of the Economy

There exists a tendency to correlate the size of enterprises to the size of the economy within which they operate, and while this is correct in the case of big businesses, because the size of the economy allows their expansion, it is incorrect as regards small businesses. The fact that a business has a small number of employees, or a low turnover, is not linked to the size of its hosting economy; yet it is linked to the economic philosophy pursued by that country. This is to say that a small business in a large economy is not necessarily larger than a small business in a small economy, but that its size is governed by the economic priniciples pursued by that regime.

It is a fact that the more socialist the economic policies pursued by a regime are, the smaller the size of the small businesses within it, and the more capitalist the economic policies, the larger the size of its small businesses. The sizes of the small businesses in the four researched countries substantiate this assertion.

In the USA, which pursues the most capitalistic economic policies of the four researched countries, are found the largest-sized small businesses. In the UK, which can be considered the second most capitalistic researched country, the size of the small businesses is correspondingly second to that of the USA. And in Israel, which is politically more to the left than the UK, having had a predominantly socialist government for some 30 years, small businesses are smaller than their counterparts in the USA or the UK. While in the People's Republic of China, which is the exponent of socialist philosophy, the size of the small business is the smallest.

Had a large country like the People's Republic of China not been included in this research, different and incorrect conclusions might have emerged, because it would have been easy to mistake the large size of

the USA's small businesses, the medium size of the UK's and the small size of Israel's as related to the size of their respective economies. But through the example of the People's Republic of China, where the size of the economy has not affected the size of its small businesses, the correct deduction can be reached, which is that the economic philosophy of a regime determines the size of its small businesses, and not the size of its economy.

(vii) The Separation of Ownership from Management Tasks in The Small Business

The inseparability of ownership and management tasks has become a hallmark of the small business. Most qualitative definitions of small business have subscribed to it[5] and considered it the key to the differences between small and big enterprises.

The observation is correct, as indeed in most small businesses ownership and management are vested in the same person; but not in all. For example, an inherited newspaper shop, which the heirs entrust to a hired manager, does not change from a small to a medium business just because the owners are the heirs and not the employed manager. The same applies to situations where the Official Receiver is called in to manage an ailing small enterprise. The ownership rights are still held by the original owners, but the management rights by the Official Receiver, who would be entitled to claim for the business any "small business" benefits, despite the separation of ownership and management functions.

These examples demonstrate that the combining of ownership and

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5 The UK definitions, see p.142.
The USA definitions, see p.95.
The German definition, see p.146.
The Italian definition, see p.167.
For socio-psychological definition, see pp. 179-181.
For economic definition, see pp. 159-177.

management tasks is not characteristic of all small businesses, and their separation cannot and should not affect the status of an enterprise. In reply to those who claim that the integration of the ownership and management functions in one person are necessary for the survival of the small business, and should therefore be a criterion of its definition, it should be pointed out that though it might be correct to state that when managerial decisions have to be backed by the finances of the manager himself, they tend to be more prudent than those made by a manager who does not have to bear the financial consequences of his own decisions; yet prudent decisions are not necessarily the best decisions, because at times a small business is saved from the brink of disaster by a bold, imprudent decision. Thus the ideal decision-maker in a small business is not necessarily its owner.

In an era when computers are also penetrating the small business world, business decision-making is becoming a skill instead of an art, and is often more suited to the hired manager than to the owner.

(viii) Private Ownership and the Small Business

Small businesses are usually associated with private ownership, in contrast to the State's or the public's. Yet it is suggested that private ownership is not a necessary element of a small business definition. Although in the western capitalist economies, the State is not out to own small businesses, it does possess them sometimes. For example, in some countries, the State becomes the heir when a deceased leaves no natural heirs, or when enterprises are appropriated by the State in lieu of death duties, or when they are willed to the nation. If, as a result, the State becomes the owner of a small business, it would most probably try to sell it; but during the transition period until it managed to dispose of it, the State would be its owner. Since this would not affect the functions or growth of the small

business, it could not be claimed that the State's ownership has transformed it from a small into a medium or a large business.

As to public companies, the fact that their ownership is open to the public is no proof that the company in question is not a small business. This can be demonstrated by the ease with which a small business can become a public company in the UK, where the **Companies Act 1980** has reduced the minimum number of members required to form a public company from seven to two.[6] Although a small business could have declared itself a public company prior to the 1980 Act, the reduction in the membership requirement has made it very much easier.[7]

The fact that in the western capitalist economies there are situations where small businesses are not privately owned should also enable the State- or commune-owned small businesses of the socialist economies to keep their small business status despite their non-private ownership.

(ix) A Small Market Share Does Not Signify a Small Business

Although the small business definitions of the USA and the UK stipulate a small market share as one of the conditions for a small business status, it is suggested that this criterion is not relevant to the definition of small businesses, because usually their small size does not enable them to have anything other than a small share of the market. The inclusion of this criterion in a small business definition would therefore prevent enterprises that succeeded in winning a large slice of the market from qualifying as small businesses, regardless of their true size; because the size of the market share is not necessarily a result of their size, but of that of the market itself. A small market which

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6 Sec.2(1).

7 Although the public company may consist of only two shareholders, it requires a minimum authorised share capital of £50,000. The Companies Act 1980, Sec.85(1).

might not attract a large business would enable a small business to monopolize or share it with other small businesses, without altering its size or changing its mode of operation. Apart from the fact that the size of the market share is not symptomatic of the size of the business, it is also not an easily verifiable criterion, as it would depend on the co-operation of all the market suppliers who would have to disclose their share of the market, before it could be ascertained who had a small share.

To determine whether a business is small or large according to its share of a specific market, means that out of two businesses with an identical number of employees, turnover, assets and managerial structure, one would be considered small if it had a small share of the market, while the other would be considered large if it had a large share of another market. A situation where identical enterprises have different rights and duties because of an external factor, the size of a market, is unacceptable. Furthermore, the condition of a small market share becomes ambiguous and inoperative once the small business has diversified production, of which the major product has a small share of its market, while the secondary product has a large share of its market. Which product would then determine the status of the business: the secondary one with the large market, or the major one with the small market?

Market share is a relative criterion, based on the size of the market; to use it as a criterion for the definition of small businesses would contribute to their differences, which is contrary to the aims of the present study.

(x) Juristic Definitions of Small Businesses are Quantitative

All the juristic definitions of small businesses have used quantitative criteria. Legislations have defined small businesses in order to

impose on them more duties than on other businesses, or to grant them more privileges. Had their duties or privileges been identical to those of other businesses, it would not have been necessary to rely on quantitative criteria for their definition, because the qualitative criteria applied to the major group would have included them as well. The difference in their duties and rights calls for a verifiable definition of their status, which can best be effected by a quantitative definition.

Furthermore, for legislation to be enforceable it has to be specific; otherwise it becomes a guide-line rather than a law in the strict sense; and specificity requires numerical determinants. Hence the observed phenomena that all juristic definitions of small business rely wholly or partially on quantitative criteria.

(xi) "Certain" and "Uncertain" Criteria

Quantitative criteria are of two types, "certain" and "uncertain".[8] The former, which include number of employees and turnover, can be established in an accurate manner and are therefore not subject to interpretations; whereas the latter, for example profits or assets, rely on evaluations and opinions.

Of these two types of criteria the most popular in legislation have been the "certain" criteria, in particular those of employment and turnover. The employment criterion has been used more often than turnover, because it is a more permanent criterion than turnover, which like all monetary criteria is subject to the fluctuations of inflation. Although the "permanency" of monetary criteria can be guaranteed by indexation to the cost of living,[9] it is not practical for a small business definition, because it would entail the businessman's constant vigilance lest the monetary determinants which had included him within the definition, or excluded him from it, changed and with them his status.

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8 See p. 339.

9 See p.384.

Another reason for the popularity of the employment criterion over the turnover one is that it can be used in all situations, while turnover cannot. In times of war or high inflation when the monetary system collapses, or in regimes that prohibit monetary exchange for commercial purposes by private enterprise, the criterion of turnover cannot function because it is replaced by a system of barter, the turnover of which cannot be assessed accurately.

Conclusion

This study set out to survey the multitude of existing definitions of small businesses with the view of replacing them with a unitary definition. This has caused the research findings to concentrate on the aspects that are essential for the foundation of such a definition; although the study has also concerned itself with the wider issues of definitions.

The deductions relate to facts about the small business and to the criteria which have been used to define it. The following are the facts that the deductions found out:

1. The existence of small businesses is proven by the special legislation they attract.
2. Small businesses are a secondary phenomenon because they are:
   (a) a subgroup of the major phenomenon of "business";
   (b) a transient and not a permanent phenomenon.
3. Small businesses, although a secondary phenomenon, display sufficient different characteristics as to merit a definition of their own.
4. Small businesses are invariably small because they deviate from the average size norm.
5. The size of the small business is determined not by the size of the economy within which it operates, but by the economic philosophy pursued by the regime.

6. Juristic definitions of small business are quantitative, because they differentiate between the duties and benefits of small business and those of other enterprises.

These factual deductions affect the definition of the small business as follows:

(a) A definition of a small business is subordinated to the definition of "business", which is its major group. The practical outcome of this is that a small business has to comply with the definition of "business" as well as with that of "small business" in order to gain a small business status.

(b) A juristic definition of small business has to consist at least in part of quantitative criteria, because these are the criteria suited to secondary phenomena like small business, and because the juristic definitions have to be useable in practice.

(c) A definition of small business can, if needed, also contain qualitative elements, because the small business is sufficiently different from the major group of businesses.

(d) The numerical determinants of whichever quantitative criteria are used to define the small business are universally applicable because the size of the economy does not affect the size of the small business; and they have to be low because a small business is invariably small.

The criteria that have been used to define small businesses have been scrutinized as to their relevancy as its definers, with the following findings:

1. There is no need to amalgamate the ownership and the management into the one entity of the owner/manager, as has been done by the USA and the UK definitions, because ownership is

separated from management and a small business can be owned by one entity and managed by another.

2. There is no need for private ownership to constitute an element of the definition, because there are situations where the State or the public own an enterprise which is small.

3. A small market share is not essentially characteristic of a small business, because the element that determines the share of the market is primarily the size of the market.

4. Small business ought to be defined by "certain" criteria in preference to "uncertain" ones, and by non-monetary criteria in preference to monetary, because of the former's stability in each case.

These findings concerning the relevant facts about the small business, and those regarding the suitability of the criteria which have been used for its definition, have paved the way for the formulation of a small business definition with an universal application.

CHAPTER SEVENTEEN

THE DEFINITION OF THE SMALL BUSINESS

(i) The definition

A small business is a business that is managed by not more than 3 managers, or whose workforce does not exceed 100 persons.

(ii) Interpretation

For the purpose of this definition:

Business means a voluntary workforce engaged in the supply of products or services for which there is a demand, and which are exchangable for money, commodities or services.

Manager means a person who has power to control the running of the business or of a section of it, either independently or jointly, and who accepts financial and/or legal and/or moral responsibility for such control, which might resultin the loss of his money, and/or freedom and/or employment.

Workforce means all the persons who work in a business, irrespective of their rank, function, the manner of their remuneration or their relationship to the ownership of the business, inclusive of a single person working in the enterprise or a self-employed person.

(iii) Explanatory Note

Three criteria, one qualitative and two quantitative, determine whether an enterprise qualifies as a small business:

1. business = qualitative;
2. management = quantitative;
3. workforce = quantitative.

Only two of the three criteria have to be complied with: the qualitative one and one of the quantitative ones.

(a) The Criteria

The criterion of "business" is essential for the definition of small business because, as elucidated,[1] small business is a sub-group of business, though with individual characteristics. Thus, a small business has first of all to satisfy the definition of business, before it can be matched to the one defining its own specific features. And though the proposed definition of business is composed of qualitative criteria[2] which on the whole are difficult to verify, the criteria that have been selected are deemed to be exceptional in this respect, for their verifiability depends on external manifestations which cannot be disguised, and can therefore be proven.[3]

The "three managers" criterion has been selected because the concentration of managerial tasks in the hands of a few managers is unique to small businesses. Had the definition focused on the method of management, i.e. the concentration of managerial tasks in a few hands, instead of on the number of managers, this would have brought in an additional qualitative criterion, which would have been difficult to interpret and substantiate. By quantifying the number of the managers in the small business, the definition achieves the same effect as that of the qualitative criterion of "concentration of managerial tasks in a few hands", with the added advantages of being clearer, simpler and easier to apply.

Three managers can control only a limited size of a business and no more, because management is a human factor, with inbuilt limitations. Although some managers might be more capable than others and succeed in controlling a larger business, a total of three managers could not control a business of any other size than small. The figure of

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1 See p. 488.

2 See p. 491.

3 Ibid.

three managers is as arbitrary as any other numerical determinant; however, its selection was based on first-hand knowledge and observation of the workings of small businesses. Furthermore, to mitigate the arbitrary effects of the numerical determinant, a second alternative quantitative criterion was introduced: "a maximum workforce of 100". Thus if a small business failed to comply with one numerical determinant, it could still qualify if it complied with the other.

The introduction of an alternative criterion is bound to minimise the arbitrary effects of the numerical determinants and most probably eliminate them. If, however, some businesses should find themselves unjustly excluded from the definition, there will probably be no more sufferers than if they had been defined according to qualitative criteria.

The use of the word "workforce" was selected in order to include within the definition not merely businesses that employ salaried workers, but also co-operatives and co-ownerships where the workers are not employees per se, but members who might be remunerated in a different manner. In any case the essence of "workforce" is persons who contribute to the process of production or the supply of services.

The "number of workers" criterion has been found to be the most reliable one for the definition of small business, since it provides an accurate reflection of its size. It is not liable to fluctuations like the monetary criterion; and it has the best track record of all the criteria, for it has been used more often than any of the others for the definition of small business.

The determinant of "not exceeding 100 workers" was selected as a counterpoise to the upper threshold of 3 managers, so that the definition could include labour-intensive industries that have a low ratio of management to workers, and technological industries with the reverse ratio. This applies also to the distinction between advanced and

developing countries, where the ratio of management to labour is high in the former and low in the latter.

The determinants of 200, 500 and 1500 employees of the UK[4] and the American[5] definitions have been rejected as unrealistically high for the definition of small business. Their figures must have been arrived at as a result of correlating smallness with a small market share. Once the accuracy of this criterion has been disputed,[6] the numerical determinants that have been influenced by it have to be rejected.

(b) The Structure

The proposed definition is based on the positive method of definition, in that it defines the small business in a direct manner. It relies on the subjective technique for defining the essential characteristics of the principal defined, "the small business"; and on the "sub-definition" procedure for defining these elements of the definition such as "business", "manager" and "workforce" that might have been subject to discord. The sub-definitions, though placed outside the formal boundaries of the definition, constitute part of it. Their exclusion was on technical and not contextual grounds, so as not to encumber the wording of the definition, and thus to facilitate its application.

In order to minimise the arbitrariness of the numerical determinants of the quantitative criteria, two measures have been taken: the definition has adopted the "upper threshold" formation, which is the least arbitrary of any definitional structure,[7] and has offered two alternative quantitative criteria, so that if a business cannot comply with one, it still has a chance of complying with the other.

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4 See p. 268.

5 See p.p. 229, 232.

6 See p p.497-498.

7 See p p.203-207.

(c) Application

The context and structure of the definition have been influenced by considerations of the practicality of its application as a legal definition, in a court of law. This is essential, because the test of any definition comes when it is disputed by an unsatisfied applicant who claims inclusion in it or exclusion from it; and this test success lies in the ability of the applicator to use it for the resolution of the dispute.

Where the applicant does not challenge the sub-definitions of "business", "manager" and "workforce", no difficulties are envisaged, since the quantitative determinants are clear; and where the qualitative aspects of "business" would have to be interpreted, the guide-lines provided for the distinction between enterprises that are included in, or excluded from, the definition[8] are deemed to be sufficient for resolving any dissention.

The interpretation of "manager" hinges on his role as a mediator between in the polarised interests of the controller and the controlled. The controller wants control without responsibility, and the controlled want the controller's responsibility without his control. The manager, as a mediator between the two, has to combine control and responsibility. The existence of control is verified by the controller's responsiility; and responsibility can be verified only by a possible "loss" to the controller. Without such a "loss", "responsibility" is just an empty, rhetorical term. The loss is not restricted to money. Where the manager is also the owner, the loss is mostly a financial one, but where the manager is a hired director of a company it is possible for him to lose his freedom if the company should breach those sections of the law that impose prison sentences on the directors. The responsibility of the hired manager who is not a director expresses itself

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8 See pp.490, 491.

in the loss of his employment. Although such a loss can be correlated with one of money, it usually results from the moral responsibility of the manager.

The interpretation of "workforce" set out to equalize four labour aspects: rank, function, method of remuneration, and relation to the ownership of the business. It was selected in preference to the more common term of "employees", which it is possible to limit only to salaried employees, thus excluding directors, managers, and certain workers, whose remunerations are linked to a percentage commission; and also excluding family and co-operative members who have a stake in the ownership of the business in addition to their capacities as workers or managers. Through using the term "workforce" no such exclusion can take place, and the number of persons who work in the business can be ascertained accurately.

Conclusion

The proposed small business definition is deemed to suit that type of business, regardless of its geographical location and political affiliations, because:

> It has isolated the characteristics that are unique to all small businesses from those that they share in common with other types of business; and it has relied on criteria that are verifiable in a practical manner and possess the least arbitrariness possible in a definition of a secondary phenomenon such as small business.

APPENDIX NUMBER 1 - Criteria and Threshold of exemptions to small employers by the Industrial Training Boards

NAME OF BOARD	ORDER NO.	TAKES EFFECT	EMPLOYEES	PAYROLL
1. Air Transport & Travel	386	8 May 1979	less than 16	(10,000)
2. Carpet	1830	24 Jan 1979	less than 26 (11)	
3. Ceramics, Glass and Mineral Products	1132	14 Sep 1978		71,000-201,000 (6,000)
4. Chemical and Allied Products	773	5 Jul 1978		170,133 (25,000)
5. Clothing and Allied Products	544	25 Jun 1979		45,000 (14,000)
6. Construction	1471	22 Nov 1978		15,000 (6,000)
7. Cotton and Allied Products	1021	6 Sep 1978		46,334 (15,000)
8. Distributive	545	25 Jun 1979	less than 10	18,500 (6,000)
9. Engineering	612	12 Jun 1978	less than 60	25,000-50,000 (35,000)
10. Food, Drink and Tobacco	387	8 May 1979		117,000
11. Footwear, Leather and Fur Skin	11	12 Feb 1979		65,000
12. Furniture and Timber	841	31 Aug 1978	less than 15	(7,500)
13. Hotel and Catering	547	16 May 1978		68,750 (6,000)
14. Iron and Steel	313	26 Apr 1979	less than 26 (11)	
15. Knitting, Lace and Net	184	2 Apr 1979	less than 24	40,000 (7,500)
16. Man-Made Fibre			NO EXEMPTIONS	
17. Paper & Paper Products	558	29 Jun 1979		93,500 (30,000)
18. Petroleum	185	26 Mar 1979	less than 11 (11)	
19. Printing		August 1979		47,000 (20,000)
Book Publishing			no more than 40	
Any other publishing except newspapers			no more than 30	
Letterpress, Block Making, Engraving			no more than 25	
All other printing			no more than 15	
20. Road Transport	940	10 Aug 1978	DRIVING INSTR-UCTORS EXEMPT	18,000-36,000 (5,000)
21. Rubber & Plastic Processing	1547	6 Dec 1978	less than 26 (10)	
22. Shipbuilding	546	25 Jun 1979		87,000 (5,000)
23. Wool, Jute & Flax	251	23 Apr 1979	less than 25	(5,000)

Sources: Levy Orders
Numbers in () relate to figures compiled by the Bolton Report as to 30 July 1971. page 250 - 255.

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